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Insurance for Punitive Damages: A Reevaluation

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INSURANCE FOR PUNITIVE DAMAGES: A REEVALUATION

Whether an insurance company can legally write a policy covering a client's liability for punitive damages is a question curiously unsettled in this country. Thus far the jurisdictions which have considered the issue have split exactly evenly. Nine have found such coverage to be available;[1] an equal number reject any coverage of a punitive damage award,[2] arguing that such coverage would completely eviscerate the punitive effect of the award.[3] The latter is the position clearly favored by the commentators[4] and seems to be the better holding in view of public policy.[5] However, since most of the cases since 1970 advocate

1. *See* Price v. Hartford Acc. & Indem. Co., 108 Ariz. 485, 502 P.2d 522 (1972); Abbie Uriguen Olds. Buick, Inc. v. United States F.I. Co., 95 Idaho 501, 511 P.2d 783 (1973); Concord Gen. Mut. Ins. Co. v. Hills, 345 F. Supp. 1090 (D. Me. 1972); Wolff v. General Cas. Co., 68 N.M. 292, 361 P.2d 330 (1961); Morrell v. Lalonde, 45 R.I. 112, 120 A. 435 (1923); Carroway v. Johnson, 245 S.C. 200, 139 S.E.2d 908 (1965); Lazenby v. Universal Und. Ins. Co., 214 Tenn. 639, 383 S.W.2d 1 (1964); Dairyland County Mut. Ins. Co. v. Wallgren, 477 S.W.2d 341 (Tex. Ct. App. 1972). *See also* Reynolds v. Willis, 209 A.2d 760 (Del. Sup. Ct. 1965).

2. *See* Brown v. Western Cas. & Surety Co., 484 P.2d 1252 (Colo. Ct. App. 1971) (not selected for official publication); Nicholson v. American Fire & Cas. Ins. Co., 177 So. 2d 52 (Fla. Ct. App. 1965); American Surety Co. v. Gold, 375 F.2d 523 (10th Cir. 1966); Caspersen v. Webber, 298 Minn. 93, 213 N.W.2d 327 (1973); Crull v. Gleb, 382 S.W.2d 17 (Mo. Ct. App. 1964); LoRocco v. New Jersey Mfrs. Indem. Ins. Co., 82 N.J. Super. 323, 197 A.2d 591 (1964); Teska v. Atlantic Nat'l Ins. Co., 59 Misc. 2d 615, 300 N.Y.2d 375 (1969); Esmond v. Liscio, 209 Pa. Super. 200, 224 A.2d 793 (1966). *See also* Tedesco v. Maryland Cas. Co., 127 Conn. 533, 18 A.2d 357 (1941).

3. See notes 51-55 & accompanying text *infra.*

4. *See, e.g.*, Hall, *The Validity of Insurance Coverage for Punitive Damages—An Unresolved Question?*, 4 N. MEX. L. REV. 65 (1973); Kendrigan, *Public Policy's Prohibition Against Insurance Coverage for Punitive Damages*, 36 INS. COUNSEL J. 622 (1969); Logan, *Punitive Damages in Automobile Cases*, 456 INS. L.J. 27 (1961); Comment, *Public Policy Prohibits Insurance Indemnification Against Awards of Punitive Damages*, 63 COLUM. L. REV. 944 (1963); Comment, *Insurer's Liability for Punitive Damages*, 14 MO. L. REV. 175 (1949); Comment, *Insurance Coverage and the Punitive Damage Award in the Automobile Accident Case*, 19 U. PITT. L. REV. 144 (1957); Comment, *Punitive Damages and Their Possible Application in Automobile Accident Litigation*, 46 VA. L. REV. 1036 (1960). *But see* Lambert, *Does Liability Insurance Cover Punitive Damages?* 517 INS. L.J. 75 (1966); Lentz, *Payment of Punitive Damages by Insurance Companies*, 15 CLEV.-MAR. L. REV. 313 (1966); Note, *Automobile Insurance Coverage for Punitive Damages*, 20 S.C.L. REV. 71 (1968).

5. See notes 51-55 & accompanying text *infra.*

coverage,[6] the current trend appears to favor an inclusive liability on the part of the insurer. This note will first discuss the current status of the issue in jurisdictions other than California. The analysis will then shift to the question of whether such insurance is or should be allowed under California law.

Background: The Doctrine of Punitive Damages

Punitive or exemplary damages are a class of money damages awarded in tort actions, usually beyond what is needed to compensate the plaintiff for the harm done by the defendant. The doctrine has been criticized repeatedly.[7] The Supreme Court of New Hampshire said: "The idea is wrong. It is a monstrous heresy. It is an unsightly and unhealthy excrescense, deforming the symmetry and body of the law."[8] Despite such criticism, punitive damages are recognized in all but four states. Only Louisiana,[9] Massachusetts,[10] Nebraska,[11] and Washington[12] have rejected the doctrine.[13]

The concept of punitive damages originally developed in the days when damages awarded in tort cases at common law were restricted to pecuniary loss and did not include such elements as mental suffering. In an early Texas case, *Stuart v. Western Union Telegraph Co.*,[14] damages for mental anguish were sought against a telegraph company for failure to deliver a death message. In holding that the injury was compensable, the court stated that a consistent failure to recognize that such injuries should enter into a proper assessment of damages had caused the courts to create a new source of damages for these injuries—the doctrine of punitive damages. When, during the 19th century, the con-

6. See notes 67-79 & accompanying text *infra*.

7. See notes 27-28, 31 & accompanying text *infra*.

8. Fay v. Parker, 53 N.H. 343, 382, 16 Am. R. 270, 320 (1873).

9. *See, e.g.*, McCoy v. Arkansas Natural Gas Co., 175 La. 487, 143 So. 383, *cert. denied*, 287 U.S. 661 (1932).

10. *See, e.g.*, Boott Mills v. Boston & M.R.R., 218 Mass. 582, 106 N.E. 680 (1914).

11. *See, e.g.*, Winkler v. Roeder, 23 Neb. 706, 8 Am. St. R. 155 (1888).

12. *See, e.g.*, Walker v. Gilman, 25 Wash. 2d 557, 171 P.2d 797 (1946). A more recent case holds that such damages are unsound in principle, but may be awarded when specifically authorized by statute. *See* Anderson v. Dalton, 40 Wash. 2d 894, 246 P.2d 853 (1952).

13. England has also abolished punitive damages except where they could serve a "useful purpose," by penalizing oppressive and arbitrary action by government servants, tortious conduct calculated to make a profit for the actor and the like. *See* Rookes v. Barnard, [1964] A.C. 1129.

14. 66 Tex. 580, 18 S.W. 351 (1855).

cept of damages was broadened to include mental suffering,[15] the result was a shift in the underlying theory of punitive damages from compensation to punishment and deterrence. The vast majority of states now impose punitive damages with the intent of punishing the wrongdoer,[16] since compensatory damages now cover nonphysical injuries. However, in some states it is still held that punitive damages are awarded not as a punishment for the defendant, but as compensation to the plaintiff, although they may, and of course do, operate as a sanction. For instance, in Connecticut, "exemplary" damages may not exceed the amount of plaintiff's expenses of litigation, less taxable costs, and hence in effect are compensatory.[17] In Michigan,[18] New Hampshire,[19] and Iowa,[20] punitive damages are awarded to compensate the plaintiff for the mental injury caused him, as distinguished from damages for actual material loss. In other jurisdictions, exemplary damages are expressly defined as encompassing both a punitive and a compensatory nature.[21]

Various theories have been advanced to justify the doctrine of punitive damages. For instance, they are defended as a method of combining public law enforcement with private vengence, and thus discouraging self help.[22] Under this "private attorney general theory,"[23] the argument is that since the victim will benefit at the expense of the wrongdoer, society is able to deter undesirable conduct that for one reason or another it chooses not to punish by criminal sanctions.[24]

Punitive damages are also justified as a way to make the admonitory function of tort actions more effective than would be the case if the money damages were limited to compensation. For example, in

15. *See* Kennon v. Gilmer, 131 U.S. 22 (1889), T. SEDGWICK, MEASURE OF DAMAGES 648 n.2 (5th ed. 1869).

16. 22 AM. JUR. 2D *Damages* § 236.

17. *See* Tedesco v. Maryland Cas. Co., 127 Conn. 533, 18 A.2d 357 (1941).

18. *See, e.g.*, Wise v. Daniel, 221 Mich. 229, 190 N.W. 746 (1922).

19. *See, e.g.*, Fay v. Parker, 53 N.H. 343, 382, 16 Am. R. 270, 320 (1873).

20. *See, e.g.*, Brause v. Brause, 190 Iowa 329, 177 N.W. 65 (1920).

21. *See, e.g.*, Louisville & N.R.R. v. Ritchel, 148 Ky. 701, 147 S.W. 411 (1912); Beck v. Dowell, 111 Mo. 506, 20 S.W. 209 (1892); Samuels v. Richmond & D.R.R., 35 S.C. 493, 14 S.E. 943 (1892); Hicks v. Herring, 144 S.E.2d 151 (S.C. 1965); Pan Am Petroleum Corp. v. Hardy, 370 S.W.2d 904 (Tex. Ct. App. 1963).

22. *See* Gostkowski v. Roman Catholic Church, 262 N.Y. 320, 186 N.E. 798 (1933).

23. *See* Walker v. Sheldon, 10 N.Y.2d 401, 170 N.E.2d 497 (1961); D. DOBBS, REMEDIES § 3.9 (1973).

24. *See* Neal v. Newburger Co., 154 Miss. 691, 123 So. 861 (1929). *See also* Abbie Uriguen Olds. Buick, Inc. v. United States F.I. Co., 95 Idaho 501, 511 P.2d 783 (1973) (concurring opinion) (encouraging the plaintiff to bring suit is a recognized corollary purpose of punitive damages).

Funk v. Kerbaugh,[25] the defendant, engaged in constructing a railroad, caused severe damage to the plaintiff's home by reckless blasting. The defendant stated that he knew injury would result but that he preferred to continue his wilful conduct, as it was cheaper to pay the resultant damages than to do the work in a way which would avoid the harm. In such a case it is evident that if the defendant were required only to make the plaintiff whole, he would not be dissuaded from future tortious conduct.

Assuming arguendo that punitive damages may have some value as a deterrent, there is some question whether the award should go to the already compensated sufferer rather than to the public on whose behalf he is punished.[26] Reserving the award for the benefit of society might permit the jury to take a more objective view of the conduct and assess an amount sufficient to achieve punishment and deterrence without unduly enlarging the award from misguided sympathy for the plaintiff, who in theory at least has been fully compensated for his losses.

Some of the strongest doubts about punitive damages concern their very nature as a punishment. As such, they are criticized as contrary to the purposes of civil law, which is intended to be compensatory, as distinct from criminal law, in which punishment is a traditional function.[27] As a punishment, punitive damages have been criticized as a potential source of double jeopardy.[28] Indiana, at least, has been persuaded by this argument and refuses to award punitive damages

25. 222 Pa. 18, 70 A. 953 (1908).

26. *See* Spokane Truck & Dray Co. v. Hoefer, 2 Wash. 45, 25 P. 1072 (1891); Bass v. The Chicago & N.R.R., 42 Wis. 654 (1877). The Nebraska Supreme Court has suggested that an award of punitive damages is a windfall and amounts to an illegal confiscation of the defendant's property for the benefit of the plaintiff. Riewe v. McCormick, 11 Neb. 261, 9 N.W. 88 (1881). *See also* DEFENSE RESEARCH INSTITUTE, THE CASE AGAINST PUNITIVE DAMAGES 28 (D. Hirsch & J. Povros eds. 1969) (monograph) [hereinafter cited as THE CASE AGAINST PUNITIVE DAMAGES]. This was a proposal of model legislation providing for the payment of any punitive damage recovery into the state treasury for the credit of the school fund.

27. *See* Duffy, *Punitive Damages: A Doctrine Which Should Be Abolished*, in THE CASE AGAINST PUNITIVE DAMAGES, *supra* note 26, at 4.

28. *See* Note, *The Imposition of Punishment by Civil Courts: A Reappraisal of Punitive Damages*, 41 N.Y.U.L. Rev. 1158 (1966). As early as 1851, the doctrine of punitive damages was challenged unsuccessfully as unconstitutional. *See* Day v. Woodworth, 54 U.S. (13 How.) 363, 370-71 (1851). Since such damages serve a purpose so similar to that of the criminal law, it has been argued that the defendant should be granted the procedural due process guarantees afforded one accused of criminal conduct. *See* Ford, *The Constitutionality of Punitive Damages*, THE CASE AGAINST PUNITIVE DAMAGES, *supra* note 26, at 15 (1969). This, of course, would change the whole nature of civil proceedings.

where the defendant is subject to criminal sanctions.[29] Other courts hold that where a defendant has been punished criminally, such punishment must be considered as a mitigating factor in awarding punitive damages.[30]

It has been further suggested that punitive awards reflect a dissatisfaction with the present doctrine of compensatory damages, and that, were they eliminated, the jury would increase the amount awarded for pain and suffering to grant the same total damages.[31] Assuming this to be true, as a defense of punitive damages it is nonetheless unsound. If the compensatory damage doctrine is inadequate, the proper solution is to liberalize it, and not to force punitive damages into serving a function other than that for which it was intended.

Despite the criticism levied against punitive damages by both courts and commentators, the doctrine has persisted. In the implementation of the law of punitive damages as applied to an insured defendant, a question arises regarding the propriety of permitting insurance against such damages. In determining whether an insured defendant can look to his insurance carrier for protection from the imposition of punitive damages, the controversy focuses on whether such damages are covered by an ordinary policy, and if so, whether this kind of insurance might defeat the whole purpose of punitive damages.

29. *See* Skufakiss v. Duray, 154 N.E. 289 (Ind. Ct. App. 1926).

30. *See, e.g.*, Saunders v. Gilbert, 156 N.C. 463, 72 S.E. 610 (1911); Jackson v. Wells, 13 Tex. Civ. App. 275, 35 S.W. 528 (1896). In West Virginia, the jury is expressly reminded to consider the punitive effect of compensatory damages before assessing an additional punitive award: "If, after the jury has assessed damages to fully compensate the plaintiff for the injury, such damages are still not sufficient in amount to punish the defendant . . . and . . . to prevent the repetition of the same or the commission of similar wrongs, they may add such further sum, in their judgment, as may be necessary for this purpose. But if the damages assessed as compensation are sufficient in amount to operate at the same time as a punishment and a warning, the jury are not authorized to add still a further and greater sum, and thus subject the defendant to a double punishment in the same case for the same wrong." Mayer v. Frobe, 40 W. Va. 246, 260, 22 S.E. 58, 63 (1895). *See also* Hess v. Marinari, 81 W. Va. 500, 94 S.E. 968 (1918).

31. *See* Comment, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517 (1957); Comment, *Insurance Coverage of Punitive Damages*, 10 IDAHO L. REV. 263 (1974). Further discussion is beyond the scope of this article; for a deeper analysis of punitive damages, see Ghiardi, *Should Punitive Damages be Abolished?—A Statement for the Affirmative*, 1965 ABA SECT. INS. NEGL. & COMP. L. 282; Corboy, *Should Punitive Damages Be Abolished?—A Statement for the Negative*, 1965 ABA SECT. INS. NEGL. & COMP. LAW 282; Willis, *Measure of Damages When Property is Wrongfully Taken by a Private Individual*, 22 HARV. L. REV. 419 (1909); THE CASE AGAINST PUNITIVE DAMAGES, *supra* note 26, at 28; Note, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517 (1957); Note, *The Imposition of Punishment by Civil Courts: A Reappraisal of Punitive Damages*, 41 N.Y.U.L. REV. 1158 (1966).

One Line of Analysis: Are Punitive Damages Covered by the Insurance Contract?

In determining whether insurance against punitive damages is available, the courts in some cases have chosen to focus on the contractual language and have merely asked whether such damages are within the coverage of the policy, never reaching the difficult social questions involved. In other cases, by contrast, the courts have based their decisions on public policy, regardless of whether punitive damages could be fitted within the terms of the insurance policy.

As a matter of contractual interpretation, most courts which have used this analysis agree that the terms of the policy embrace liability for punitive damages.[32] *United States Fidelity & Guaranty Co. v. Janich*[33] is typical of the early cases which often addressed only the issue of coverage. In that case, the policy obligated the insurer to "pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of liability imposed by law."[34] The court simply stated that such a broad provision would be construed to cover punitive damages. *Ohio Casualty Insurance Co. v. Welfare Finance Co.*[35] likewise held that "since this [insurance] policy clearly covers bodily damage through negligence, and since these punitive damages are imposed because of the aggravated circumstances or form of this negligence, such punitive damages must be regarded as coming within the meaning of the policy."[36] The South Carolina court, in the recent case of *Carroway v. Johnson*,[37] faced a more typical insurance policy requiring the insurer to "pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of . . . bodily injury . . . ."[38] The court simply decided that since

32. *See* General Cas. Co. of America v. Woodby, 238 F.2d 452 (6th Cir. 1956); Ohio Cas. Ins. Co. v. Welfare Finance Co., 75 F.2d 58 (8th Cir. 1934); Concord Gen. Mut. Ins. Co. v. Hills, 345 F. Supp. 1090 (D. Me. 1972); Southern Farm Bureau Cas. Ins. Co. v. Daniel, 246 Ark. 849, 440 S.W.2d 582 (1969); Abbie Uriguen Olds. Buick, Inc. v. United States F.I. Co., 95 Idaho 501, 511 P.2d 783 (1973); Carroway v. Johnson, 245 S.C. 200, 139 S.E.2d 908 (1965); Dairyland County Mut. Ins. Co. v. Wallgren, 477 S.W.2d 341 (Tex. Ct. App. 1972). For cases contra, see notes 48-49 & accompanying text *infra*.

33. 3 F.R.D. 16 (S.D. Cal. 1943).

34. *Id.* at 19.

35. 75 F.2d 58 (8th Cir. 1934) (applying Missouri law), *cert. denied*, 295 U.S. 734 (1935).

36. *Id.* at 59.

37. 245 S.C. 200, 139 S.E.2d 908 (1965), *noted in* 25 MD. L. REV. 326 (1965).

38. 245 S.C. 200, 202, 139 S.E.2d 908, 909 (1965). In this case, the defendant insurance company relied on an earlier South Carolina case in which the court had held

the punitive damage award was obviously one which the insured was legally obligated to pay, and since such award further arose from the injuries sustained by the plaintiff, it was within the policy provisions.[39] Such an argument turns on the established rules of interpretation of adhesion contracts, which require a strict construction in favor of the insured.[40] In none of these cases, however, did a court expressly consider the public policy issue.

In failing to discuss the public policy issue, courts may simply be implying that the social policy favoring enforcement of contracts outweighs the policy of deterrence which underlies punitive damages. In the leading case allowing recovery from an insurance company, *Lazenby v. Universal Underwriters Insurance Co.*,[41] the court stated this argument as follows:

> The insurance contract in the case at bar is a private contract between defendant and their assured . . . which when construed as written would be held to protect him against claims for both compensatory and punitive damages. Then to hold assured, as a matter of public policy, is not protected by the policy on a claim for punitive damages would have the effect to partially void the contract.[42]

Courts favoring the sanctity of contract over the punishment of the wrongdoer have alternatively found coverage by emphasizing the ex-

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that insurance issued under the uninsured motorist statutes did not provide for the payment of punitive damages to a person injured in a collision with an uninsured motorist. The court in that case specifically declined to decide whether such insurance for punitive damages would violate public policy.

39. *See* Carroway v. Johnson, 245 S.C. 200, 205, 139 S.E.2d 908, 910 (1965), stating: "The policy under consideration did not limit recovery to actual or compensatory damages. The language of the policy here is sufficiently broad enough to cover liability for punitive damages as such damages are included in the 'sums' which the insured is legally obligated to pay as damages because of bodily injury within the meaning of the policy." *Id.* For additional cases following the theory that punitive damages are within the policy terms, see note 32 *supra.*

40. See notes 44-45 *infra.*

41. 214 Tenn. 639, 383 S.W.2d 1 (1964).

42. *Id.* at 648, 383 S.W.2d at 5. *See also* Capital Motor Lines v. Loring, 238 Ala. 260, 263, 189 So. 897, 899 (1939) (insurer's liability to pay punitive damages arises out of its obligation to pay judgment rendered against insured). The Arizona Supreme Court has declared: "[T]he state of Arizona has more than one public policy. . . . One such public policy is that an insurance company which admittedly took a premium for covering *all* liability for damages, should honor its obligation." Price v. Hartford Acc. & Indem. Co., 108 Ariz. 485, 487, 502 P.2d 522, 524 (1972). *Cf.* Wolff v. General Cas. Co. of America, 68 N.M. 292, 361 P.2d 330 (1961). In *Wolff* the court agreed that public policy precludes persons from purchasing pacts indemnifying them against the consequences of their wilful acts. However, the court declined to use this policy as the basis for an implied exclusion of wilful conduct in the absence of evidence that the parties intended such an exclusion. *Id.*

pectation interest of the insured.[43] These courts have supported such a conclusion by citing the established rules that (1) where the language is unclear, the policy must be construed most strongly against the insurer as drafter,[44] and (2) the meaning of any term must be tested ultimately by the expectation of the insured.[45] However, if the tortfeasor expects that the penalty for his action will be covered by his insurance, all deterrent effect of punitive damages is, of course, negated.[46] This expectation argument, for example, was summarily disposed of by the Florida court: "We believe that a person has no right to expect the law to allow him to place responsibility for his reckless and wanton acts on someone else."[47]

The process of construction, of course, has not invariably led to a conclusion that coverage exists. For example, several courts have construed similarly worded insurance policies in a way that precluded recovery for punitive damages. The Colorado court, following the majority view as to the nature of exemplary damages, has held that the punitive award was primarily intended to punish the wrongdoer rather than to compensate the aggrieved party for bodily injury, and thus was outside the terms of the policy, which limited coverage to compensatory damages imposed for such injury.[48] More recently, the Missouri court stated:

> There is no language in the policy that provides for the payment of judgments for punitive damages. The policy covers only

43. *See, e.g.*, Lazenby v. Universal Underwriters Ins. Co., 214 Tenn. 639, 383 S.W.2d 1 (1964). *See also* 7 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4312, at 132 (1942). The author expresses the opinion that "if it is clear that the average insured contemplates protection against claims of any character caused by his operation of an automobile, not intentionally inflicted . . . ." In his 1972 supplement the author continues: "In any event a court should not aid an insurer which fails to exclude liability for punitive damages. Surely there is nothing in the insuring clause that would forewarn an insured that such was to be the intent of the parties."

44. 43 AM. JUR. 2D *Insurance* § 271.

45. *See* Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 54 Cal. Rptr. 104, 419 P.2d 168 (1966); Note, *Insurance Contracts and the Doctrine of Reasonable Expectation*, 6 THE FORUM 116 (1971).

46. This argument can be consistently applied only in that minority of states which follows a theory of punitive damages as compensatory in nature, for if compensation is the objective, the expectation of the insured is immaterial. See text accompanying notes 17-21 *supra*. The Arizona court, rejecting this contention, held that insurance did not mean the driver could engage in wanton acts with impunity, since he would be subject to criminal penalties and soaring premiums. Price v. Hartford Acc. & Indem. Co., 108 Ariz. 485, 502 P.2d 522 (1972). See notes 73-75 & accompanying text *infra*.

47. Nicholson v. American Fire & Cas. Ins. Co., 177 So. 2d 52 (Fla. Ct. App. 1965).

48. Universal Indem. Ins. Co. v. Tenery, 96 Colo. 10, 39 P.2d 776 (1934).

> damages for bodily injury and property damage sustained by any person. Punitive damages do not fall in this category. The $2000 award of punitive damages to plaintiff was to punish defendant for his wrongful acts and as a warning to others. It was not to compensate the plaintiff for bodily injury and property damage.[49]

Thus, analysis based primarily on determining the proper construction of a particular insurance policy has led to different results in different jurisdictions. Though such analysis may be plausible, it is nonetheless incomplete; it leaves the determination of public policy questions involved to mere implication.

Other courts, however, have determined the construction issue to be immaterial,[50] and have addressed instead the public policy issue directly.

A Second Line of Analysis: Coverage of Punitive Damages Is Contrary to Public Policy

The earliest case referring to public policy is the Colorado case of *Universal Indemnity Insurance Co. v. Tenery*.[51] The court did not specifically address the public policy question, but said that because punitive damages were awarded as a punishment, and because the insurance company did not agree to indemnify for more than bodily injuries, "[t]he injured party will not be allowed to collect from a nonparticipating party for a wrong against the public."[52]

The leading case prohibiting coverage for punitive damages by insurance companies under a public policy theory is *Northwestern National Casualty Co. v. McNulty*.[53] Defendant, insured under a policy issued in Virginia, lost control of his car while intoxicated. The plaintiff suffered severe injuries, and brought suit for compensatory and punitive damages in Florida, where the accident occurred. The plain-

49. Crull v. Gleb, 382 S.W.2d 17 (Mo. Ct. App. 1964). *See also* Caspersen v. Webber, 298 Minn. 93, 213 N.W.2d 327 (1973).

50. *See* American Surety Co. v. Gold, 375 F.2d 523 (10th Cir. 1966); Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432 (5th Cir. 1962); Nicholson v. American Fire & Cas. Ins. Co., 177 So. 2d 52 (Fla. Ct. App. 1965).

51. 96 Colo. 10, 39 P.2d 776 (1934).

52. *Id.* at 17, 39 P.2d at 779. The case involved the liability of an insurance company on a policy issued to the Hertz system to cover drivers of their rented cars. The case could thus be distinguished, and Hertz could have been indemnified on the ground that liability was not personal, but the court did not base its decision on this. Furthermore, the Colorado court has recently affirmed the holding in two cases involving personal liability. *See* Brown v. Western Cas. & Surety Co., 484 P.2d 1252 (Colo. Ct. App. 1971) (not selected for official publication); Gleason v. Fryer, 30 Colo. App. 106, 491 P.2d 85 (1971).

53. 307 F.2d 432 (5th Cir. 1962); *see* 36 U. COLO. L. REV. 287 (1964).

tiff was awarded a total of $57,000, including $20,000 punitive damages. Plaintiff and defendant driver brought a garnishment action to recover up to the policy limit of $50,000, and from a summary judgment in their favor the insurance company appealed, protesting the liability for punitive damages. Judge Wisdom's opinion hinged on the public policy behind punitive damages in Florida and Virginia. He pointed out that since exemplary damages are awarded as a deterrent, allowing the insured to shift the burden to the insurance company would negate the purpose of the sanction:

> Where a person is able to insure himself against punishment he gains a freedom of misconduct inconsistent with the establishment of sanctions against such misconduct. It is not disputed that insurance against criminal fines or penalties would be void as violative of public policy. The same public policy should invalidate any contract of insurance against the civil punishment that punitive damages represent.
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> The policy considerations in a state where, as in Florida and Virginia, punitive damages are awarded for punishment and deterrence, would seem to require that the damages rest ultimately as well as nominally on the party actually responsible for the wrong. If that person were permitted to shift the burden to an insurance company, punitive damages would serve no useful purpose. Such damages do not compensate the plaintiff for his injury, since compensatory damages already have made the plaintiff whole. And there is no point in punishing the insurance company; it has done no wrong. In actual fact, of course, and considering the extent to which the public is insured, the burden would ultimately come to rest not on the insurance companies but on the public, since the added liability to the insurance companies would be passed along to the premium payers. Society would then be punishing itself for the wrong committed by the insured.[54]

Most of the legal commentators on this subject supported this conclusion even before *McNulty*.[55] The logic of the argument seems undeniable; if punitive damages are intended to punish a wrongdoer, allowing insurance coverage frustrates the essential effect of the award by permitting the tortfeasor to escape the sting of the sanction.

Argument: Public Policy Does Not Prohibit Coverage of Punitive Damages

Two years after *McNulty*, the Supreme Court of Tennessee was faced with a similar case. In *Lazenby v. Universal Underwriters Insurance Co.*,[56] the plaintiff sustained personal injuries resulting from

54. 307 F.2d 432, 440 (5th Cir. 1962).

55. See note 4 *supra*.

56. 214 Tenn. 639, 383 S.W.2d 1 (1964); *see* Long, *Insurance Protection Against Punitive Damages*, 32 TENN. L. REV. 573 (1965).

the negligence of the intoxicated defendant driver, and was awarded punitive as well as compensatory damages. The defendant driver's insurance company agreed to pay the compensatory damages but denied liability for the punitive damages, claiming that they were not covered by the contract. The court, although acknowledging that exemplary damages in Tennessee are awarded as a punishment and deterrent, rejected the insurance company's argument and found the insurer liable for all damages awarded. Perhaps most important, the court rejected the public policy argument:

> Public policy is practically synonymous with public good and unless the private contract is in terms of such a character as to tend to harm or injure the public good, public interest [or] public welfare or to violate the Constitution, laws . . . or judicial decisions of the State, it is not violative of public policy nor void on that account.[57]

Although coverage of a punitive award by insurance is a result espoused by at least nine jurisdictions, most do not state their rejection of the public policy argument as definitively as did the Tennessee court. The public policy argument rests heavily on the concept of such damages as a punishment and deterrent, and thus is inherently susceptible of two rebuttals; either (1) that the deterrent effect of punitive damages is nil, or (2) that punitive damages are "compensatory" in some sense and thus coverage is not inconsistent with public policy.

Lazenby, the leading case advocating coverage, provides an example of the first type of argument. There the court stated:

> We . . . are not able to agree [that] the closing of the insurance market, on the payment of punitive damages, to [socially irresponsible] drivers would necessarily accomplish the result of deterring them in their wrongful conduct. This State, in regard to the proper operation of motor vehicles, has a great many detailed criminal sanctions, which apparently have not deterred this slaughter on our highways and streets. Then to say the closing of the insurance market, in the payment of punitive damages, would act to deter guilty drivers would in our opinion contain some element of speculation.[58]

57. 214 Tenn. 639, 648, 383 S.W.2d 1, 5 (1964).

58. *Id. See also* Price v. Hartford Acc. & Indem. Co., 108 Ariz. 485, 502 P.2d 522 (1972) (suggesting if insurance is allowed, deterrence is effected by the possibility that award will exceed policy coverage). If the deterrent effect is questioned, a more effective argument can be advanced. The action of the insured must be unintentional to be within the policy at all; where punitive damages are thus awarded for gross negligence or recklessness, rather than an intentional tort, and thus where there is no mens rea, any punishment might have little effect. For a different view, see Lambert, *Does Liability Insurance Cover Punitive Damages?* 517 INS. L.J. 75, 81 (1966). The author argues that "insurance companies today take great interest and pride in promoting safer driving. Their interest may diminish and fade if they cease to be liable for punitive damages.

This argument can be countered, however. As the court stated in *American Surety Co. of New York v. Gold*:[59]

> [W]e may as well say criminal sanctions serve no useful purpose just because they are constantly violated. The question is not so much the efficacy of the policy underlying punitive damages; rather it is a question of the implementation of that policy. Permitting the penalty for the misdeed to be levied on one other than he who committed it cannot possibly implement the policy.[60]

The second argument that public policy does not preclude coverage is that in some states, at least, the purpose of punitive damages is not only punishment but also enlarged compensation.[61] The Connecticut case of *Tedesco v. Maryland Casualty Co.*[62] is often cited in this regard. Here, after compensatory damages had been assessed, an additional amount was imposed on the defendant as a penalty under the state's treble damage statute. The court found the carrier not liable for the penalty, but held that a claim for other kinds of punitive damages might be covered under the policy in question. The decision hinged on the nature of the punishment inflicted. In Connecticut, punitive damages are compensatory, as they "are limited to the costs of litigation less taxable costs. . . ."[63] But because the particular statute involved in *Tedesco* was penal in nature, insurance coverage was precluded:

> A policy which permitted an insured to recover from the insurer fines imposed for a violation of a criminal law would certainly be against public policy. The same would be true of a policy which expressly covered an obligation of the insured to pay a sum of money in no way representing injuries or losses suffered by the plaintiff but imposed as a penalty because of a public wrong. . . . In this case, the additional sum representing the doubling of the compensatory damages is, in its essence, a liability imposed, not for damages because of bodily injury, but as a reward for securing the punishment of one who has committed a wrong of a public nature.[64]

Thus, this case supports coverage for punitive damages, but only where they are compensatory. Absent the compensatory nature of punitive damages, the court would have held against coverage.[65]

Why deprive the automobile liability carriers of any incentive to promote ever safer driving?" *Id.*

59. 375 F.2d 523 (10th Cir. 1966).

60. *Id.* at 527.

61. See notes 17-21 & accompanying text *supra.*

62. 127 Conn. 533, 18 A.2d 357 (1941). *See also* 40 MICH. L. REV. 128 (1941).

63. Chykirda v. Yanush, 131 Conn. 565, 568, 41 A.2d 449, 450 (1945).

64. 127 Conn. at 537, 18 A.2d at 359.

65. Similarly, two cases arising in Alabama are often mistakenly cited in support of the position that an insurance company can be held liable for punitive damages. Both

Tedesco, then, is not in conflict with *McNulty*, for in the latter case the court limited its proscription to those "damages awarded with a view to punish the defendant for irresponsible conduct and to deter the defendant and others from similar misconduct."[66]

In any event, neither the argument that punitive damages have no deterrent value nor the argument that punitive damages are compensatory effectively refutes the public policy argument against coverage as explicated in *McNulty*. The fact remains that by passing the ultimate liability for punitive damages along to an insurance company, the tortfeasor is relieved of any penalty for his act. This, of course, defeats the whole purpose behind punitive damages and accordingly is an unacceptable result in jurisdictions where such damages are thought to further an important public policy.

Insurance for Punitive Damages: The Trend in Recent Cases

McNulty and *Lazenby* thus represent the two polar positions on the issue of insurance for punitive damages. Currently the states which have decided the issue are equally divided;[67] but of the seven cases since 1970, four have allowed coverage on various theories. As the three noncoverage cases represent only two jurisdictions, this may

cases involved the Alabama wrongful death statute, and both held the insurer liable. *See* Capital Motor Lines v. Loring, 238 Ala. 260, 189 So. 897 (1939); American Fid. & Cas. Co. v. Werfel, 230 Ala. 552, 162 So. 103 (1935). However, under Alabama law, all damages awarded in an action for wrongful death are deemed punitive. In the *Werfel* case, the court said, "The policy, being broad enough to cover personal injury or death as the result of an accident occurring while the policy was in force, was therefore broad enough to cover liability for death, and recovery under the homicide statute for wrongful death. This recovery would have been for punitive damages purely. It may not be successfully contended that the policy did not protect against punitive damages for bodily injuries so inflicted." 230 Ala. 552, 556, 162 So. 103, 106 (1935) (citations omitted). Thus, to provide any compensation at all to a plaintiff in such an action, insurance must be permitted, but as the intent of the award is not primarily punitive, no public policy is violated by allowing insurance.

One writer has suggested that Employers Ins. Co. v. Brock, 233 Ala. 551, 172 So. 671 (1937), has extended this policy of coverage for punitive damages to an action arising under the state's automobile guest statute, which does not contain the same quirk of compensation. *See* 63 COLUM. L. REV. 944, 947 (1963). In *Brock*, the court said, "At the trial the simple negligence count was submitted and the jury duly instructed in the oral charge as to such issue and damages. The damages recovered were within the terms of the policy construed in the *Werfel* Case. . . ." 233 Ala. at 553, 172 So. at 673. If the insurer was held liable for the punitive damages awarded in this case, it was on a count of simple negligence, which is contrary to the weight of authority. *See* 15 AM. JUR. *Damages* § 274 (1938).

66. Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 442 (5th Cir. 1962).

67. See notes 1-2 *supra*.

presage a trend toward following the *Lazenby* decision and upholding coverage for punitive damages.

For example, the district court for Maine in the case of *Concord General Mutual Insurance Co. v. Hills*[68] gave a judgment for the insured based on a contract interpretation argument, stating merely that "it is well settled that such broad provisions in automobile liability policies unmistakably include both compensatory and punitive damages."[69] While this may be true, it hardly establishes the propriety of such coverage, an issue the court does not discuss.

A recent Idaho case, *Abbie Uriguen Oldsmobile Buick, Inc. v. United States Fire Insurance Co.*,[70] also allowed coverage. There the Idaho Supreme Court acknowledged the construction argument and agreed that insurance policies must be construed liberally, and then, after extensive quotes from *McNulty* and *Lazenby*, accepted the latter decision without independent reasoning.

The Texas court in *Dairyland County Mutual Insurance Co. v. Wallgren*[71] also allowed coverage, after considering the construction issue and an interesting variation on the public policy argument. The court concluded:

> [T]erms and conditions set out in the insurance contract before us—having been prescribed and approved by the Insurance Commission—accord with and represent the public policy of the state. Stated another way: the terms and conditions of the policy do not contravene public policy.[72]

Finally, the Arizona case of *Price v. Hartford Accident & Indemnity Co.*[73] also made a different kind of public policy argument, holding that "the state of Arizona has more than one public policy. . . . One such public policy is that an insurance company, which admittedly took a premium for covering *all* liability for damages, should honor its obligation."[74] The Arizona court bolstered its decision with five other assertions, including an enumeration of other penalties to which the

68. 345 F. Supp. 1090 (D. Me. 1972).

69. *Id.* at 1095. The court cited United States Fid. & Guar. Co. v. Janich, 3 F.R.D. 16, 19 (S.D. Cal. 1943).

70. 95 Idaho 501, 511 P.2d 783 (1973); *see* Note, *Insurance Coverage of Punitive Damages*, 10 IDAHO L. REV. 263 (1974).

71. 477 S.W.2d 341 (Tex. Ct. App. 1972); *see* Note, *Exemplary Damages—An Insurable Risk for Texas Drivers*, 10 HOUST. L. REV. 192 (1972).

72. 477 S.W.2d 341, 342 (Tex. Ct. App. 1972).

73. 108 Ariz. 485, 502 P.2d 522 (1972).

74. *Id.* at 487, 502 P.2d at 524. It may be questioned, however, whether rates are in fact set for total coverage, that is, whether the premiums are assessed in an amount sufficient to cover punitive awards.

insured is exposed, and a rejection of *McNulty's* argument that allowing insurance would result in an additional burden on the driving public.[75] Thus, it is clear that none of the recent pro-coverage cases really refute the essential public policy argument of deterrence as stated in *McNulty*; however, the three recent cases which reject coverage likewise fail to discuss expressly the public policy issue.

In *Caspersen v. Webber*,[76] the Supreme Court of Minnesota held that the punitive damages were awarded to the plaintiff as a punishment and deterrent, and not as compensation for bodily injury, and thus the company's policy, which required it to pay "all sums the insured shall be legally obligated to pay as damages because of bodily injury"[77] afforded no coverage for punitive damages. In Colorado, the court of appeals also used a construction argument and held in two cases[78] that *Universal Indemnity Insurance Co. v. Tenery*[79] was controlling; that is, that punitive damages are not compensatory and are not covered by an insurance policy even though not specifically excluded. These three cases, while reaching the same result as *McNulty*, are phrased in terms of canons of construction, not considerations of public policy, although the Minnesota court did cite *McNulty* to support its decision.

Thus, it can be seen that jurisdictions across the country currently are equally divided on the question of the liability of an insurer for a punitive damage award. Although the recent cases show a slight numerical majority in favor of coverage, and thus may represent something of a trend, the evidence is at best inconclusive.

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75. *Id.* The court continued: "First, even though a driver is insured for punitive damages he cannot engage in wanton conduct with impunity. In the instant case, drag racing would subject him to criminal penalties. His insurance rates would soar. . . . Second, Hartford has voluntarily covered its insured's liability for punitive damages, and since its premiums were based on its exposure, it may be presumed that holding it liable for what it has promised to pay would not result in additional burdens on the driving public. Third, the criminal penalties include possible loss of the driver's license and compulsory attendance at the traffic school. Fourth, punitive damages are not only designed to punish the offender but are also designed to serve as a deterrent to others. Since it is common knowledge that the vast majority of drivers do not carry million dollar liability policies, the possibility that punitive damages will exceed their policy limits will exercise a deterrent effect on them. Fifth, there is no evidence that those states which deny coverage have accomplished any appreciable effect on the slaughter on their highways." *Id.*

76. 298 Minn. 93, 213 N.W.2d 327 (1973).

77. *Id.* at 99, 213 N.W.2d at 331.

78. Brown v. Western Cas. & Surety Co., 484 P.2d 1252 (Colo. Ct. App. 1971) (not selected for official publication); Gleason v. Fryer, 30 Colo. App. 106, 491 P.2d 85 (1971).

79. 96 Colo. 10, 39 P.2d 776 (1934). See notes 48, 51-52 & accompanying text *supra*.

California has never squarely faced the issue.[80] The case of *United Fidelity & Guaranty Co. v. Janich*,[81] which involved a partnership as the insured party, was a federal diversity action decided in 1943, and has been cited as indicating that coverage for punitive damages is available.[82] However, given the statutorily defined purpose and the public policy underlying the imposition of such damages in California case law,[83] an argument will be made in this note that, *Janich* notwithstanding, California courts would adopt a policy against coverage.

The holding in *Janich* is not without merit when confined to its facts, that is, a situation in which the injured party is vicariously liable for the acts of an employee. Vicarious liability for punitive damages, as will be seen, raises an entirely different sort of question. Three states have faced the issue of coverage only in this context, and have found for coverage.[84] Of those states which have determined that insurance does not cover a punitive damage award, five have established an exception for vicarious liability.[85] When the impact of the award falls on one liable only under respondeat superior, no public policy is violated by allowing insurance. As a result, California should, consistent with its statutes and prevailing case law, adopt a policy of noncoverage generally, but should allow insurance to cover an award of punitive damages when the insured is only vicariously liable.

California's Position on Punitive Damages

The Status of California Statutes and Their Construction

In California, a discussion of whether insurance is available for punitive damages must begin by examining the pertinent statutes. Civil Code section 3294 provides:

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80. *But see* 59 OP. ATT'Y GEN. 204 (1976) (insurance for school board members).

81. 3 F.R.D. 16 (S.D. Cal. 1943).

82. Annot. 20 A.L.R.3d 343; Concord Gen. Mut. Ins. Co. v. Hills, 345 F. Supp. 1090 (D. Me. 1972). See note 68 *infra*.

83. See notes 90-132 & accompanying text *infra*.

84. *See* Southern Farm Bureau Cas. Ins. Co. v. Daniel, 246 Ark. 849, 440 S.W.2d 582 (1969); United States Fid. & Guar. Co. v. Janich, 3 F.R.D. 16 (S.D. Cal. 1943); Scott v. Instant Parking, Inc., 105 Ill. App. 2d 133, 245 N.E.2d 124 (1969).

85. *See* Universal Indem. Ins. Co. v. Tenery, 96 Colo. 10, 39 P.2d 776 (1934); Sterling Ins. Co. v. Hughes, 187 So. 2d 898 (Fla. Ct. App. 1966); Travelers Ins. Co. v. Wilson, 261 So. 2d 545 (Fla. Ct. App. 1972); Continental Ins. Cos. v. Hancock, 507 S.W.2d 146 (1973); Malanga v. Mfrs. Cas. Ins. Co., 28 N.J. 220, 146 A.2d 105 (1958); Ohio Cas. Ins. Co. v. Welfare Finance Co., 75 F.2d 58 (8th Cir. 1934) (applying Missouri law), *cert. denied*, 295 U.S. 734 (1935). *See* Esmond v. Liscio, 209 Pa. Super. 200, 224 A.2d 793 (1967) (dicta).

> In an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, express or implied, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant.[86]

Under this section, punitive damages in California are imposed strictly as a punishment.[87] There are no compensatory aspects involved.[88]

In applying this statute, some California courts have held that the malice required therein can be found only in cases involving a wilful or intentional act. In *Gombos v. Ashe*,[89] for example, the court of appeal declared:

> In order to warrant the allowance of [punitive] damages the act complained of must not only be wilful, in the sense of intentional, but it must be accompanied by some aggravating circumstance, amounting to malice. . . . Mere negligence, even gross negligence, is not sufficient to justify such an award.[90]

Apparently, punitive damages would be imposed on a wrongdoer only in cases of intentional torts. In such circumstances, it is clear that insurance coverage is not ordinarily available even for compensatory damages: California statutes prohibit any coverage of a wilful act, as it is considered contrary to public policy to indemnify one from the consequences of his intentional torts. Thus, section 533 of the Insurance Code provides:

> An insurer is not liable for a loss caused by the wilful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured's agents or others.[91]

This statute, which precludes coverage of liability resulting from a wilful act, and section 3294 of the Civil Code, which requires malice as a prerequisite to an award of punitive damages, appear to render moot any question of an insurer's liability for punitive awards, given that California case law indicates that the term "malice" implies "wilful act."[92]

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86. CAL. CIV. CODE § 3294 (West 1970). *See also* Fitzpatrick v. Clark, 26 Cal. App. 2d 710, 713, 80 P.2d 183, 184 (1938). "The right to recover punitive damages arises solely by virtue of section 3294 of the Civil Code . . . ." *Id.*

87. *See* Ward v. Taggart, 51 Cal. 2d 736, 336 P.2d 534 (1959); Gudarov v. Hadjieff, 38 Cal. 2d 412, 240 P.2d 621 (1952); Hall v. Berkell, 130 Cal. App. 2d 800, 279 P.2d 832 (1955).

88. *See* Brewer v. Second Baptist Church, 32 Cal. 2d 791, 197 P.2d 713 (1948).

89. 158 Cal. App. 2d 517, 322 P.2d 933 (1958).

90. *Id.* at 526, 322 P.2d at 939; *see* 23 CAL. JUR. 3D *Damages* § 123 (1975).

91. CAL. INS. CODE § 533 (West 1972).

92. In California, under the statutes, negligence alone will not support a punitive damage award. *See* Spencer v. San Francisco Brick Co., 5 Cal. App. 126, 89 P. 851 (1907); Moody v. McDonald, 4 Cal. 297 (1857); Farbstein & Stillman, *Insurance for the Commission of Intentional Torts*, 20 HASTINGS L.J. 1219 (1969). Many of the

For instance, in *Maxon v. Security Insurance Co.*,[93] the insured brought an action to recover costs expended in defending (unsuccessfully) a malicious prosecution action after the insurance company refused to furnish a defense under the policy. The court held that the malice established by the judgment against the insured in the original suit established the occurrence of a "wilful act" within the meaning of section 533 of the Insurance Code and thus relieved the insurer of liability.[94] Though *Maxon* has in part been superseded,[95] it illustrates the fact that a finding of malice, necessary to support a punitive damage award, has been held to remove the act from insurance coverage.

The question of insurance for punitive damages in California, in theory at least, is not foreclosed either by the characterization of malice as implying a wilful act or by the express language of Insurance Code section 533. Recent case law indicates, for example, that malice need not always be intentional;[96] furthermore, exceptions to section 533 have been well established. Hence, an act may be malicious and yet covered by insurance at least as to the compensatory damages, or the act might be intentional and yet within the policy despite section 533.

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leading cases in other jurisdictions have dealt with an award of punitive damages given against a drunken driver. See cases cited in notes 41, 49, 51, 53, 70 *supra*. California, on the contrary, has long had the rule that "[O]ne who becomes intoxicated, knowing he intends to drive his automobile on the highway, is of course negligent, and perhaps grossly negligent. . . . But it is not a malicious act. California has already ruled that punitive damages may not be recovered because of the intoxication of an automobile driver." Gombos v. Ashe, 158 Cal. App. 2d 517, 528, 322 P.2d 933, 940 (1958); *accord*, Strauss v. Buckley, 20 Cal. App. 2d 7, 65 P.2d 1352 (1937). *Compare* Ross v. Clark, 35 Ariz. 60, 274 P. 639 (1929), *with* Dearing v. Ferrell, 165 F. Supp. 508 (W.D. Ark. 1958). *But see* Miller v. Blanton, 213 Ark. 246, 210 S.W.2d 293 (1948). This strictly limits the field of application in California of punitive damages for a nonintentional tort.

93. 214 Cal. App. 2d 603, 29 Cal. Rptr. 586 (1963).

94. In *Maxon*, suit was brought under a storekeeper's policy for malicious prosecution. Some liability coverage policies provide indemnity for sums arising from such hazards as malicious prosecution, false arrest or libel, torts which include an element of malice by their very nature, and thus are particularly subject to punitive damages. It would seem then that punitive damages are contemplated by such a policy, and some states have held that the insurer should then be liable. In a Missouri case involving false arrest insurance, the policy covered the insured "against loss by reason of liability imposed by law upon the assured, by reason of any false arrest . . . ." Colson v. Lloyd's of London, 435 S.W.2d 42 (Mo. Ct. App. 1968). In allowing coverage the court distinguished automobile cases such as Crull v. Gleb, 382 S.W.2d 17 (Mo. Ct. App. 1964), arising in the same state, and which had held that insurance against punitive damages was contrary to public policy.

95. *See* Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

96. See note 97 & accompanying text *infra*.

A very recent case, *G.D. Searle & Co. v. Superior Court*,[97] has held that malice need not be intentional. "[M]alice," the court said, "extends beyond deliberate injury and may characterize aggravated and culpable instances of nondeliberate conduct."[98] The court suggested "conscious disregard of safety" as a standard for awarding punitive damages in cases of nondeliberate injury.[99] The standard is similar to that used to define gross negligence, wanton negligence,[100] or reckless misconduct.[101] The Supreme Court of California has stated that no form of negligence removes an act from coverage;[102] although there is no California authority, other courts have held reckless acts to be covered by insurance.[103] Thus, if an act which is reckless evinced a conscious disregard of safety, an award of punitive damages would be supported, but the insurance company could theoretically still be liable for the compensatory damages arising from the act. In such a case,

97. 49 Cal. App. 3d 22, 122 Cal. Rptr. 218 (1975).

98. *Id.* at 30, 122 Cal. Rptr. at 223.

99. *Id.* at 32, 122 Cal. Rptr. at 225; *see* Sturges v. Charles L. Harney, Inc., 165 Cal. App. 2d 306, 322, 331 P.2d 1072, 1081 (1958), in which the court said: "[T]he courts of this state have long recognized that punitive damages are recoverable for an area of tortious conduct more culpable than negligence, but falling short of intentional conduct."

100. *See, e.g.*, Emery v. Emery, 45 Cal. 2d 421, 426, 289 P.2d 218, 221 (1955). "Wilful misconduct implies at least the intentional doing of something with a knowledge that serious injury is a *probable* . . . result, or the intentional doing of an act with a wanton and reckless disregard of its possible result." *Id.*

101. *See* Donnelly v. Southern Pacific Co., 18 Cal. 2d 863, 869, 118 P.2d 465, 468 (1941). "[Wanton and reckless misconduct] occurs when a person with no intent to cause harm intentionally performs an act so unreasonable and dangerous that he knows, or should know, it is highly probable that harm will result." *Id.*

102. *See* McKenzie v. Scottish Union & Nat'l Ins. Co., 112 Cal. 548, 557-58, 44 P. 922, 925 (1896). "Under section 2629 [now section 533 of the Insurance Code] the nice distinctions often made necessary are dispensed with and the general proposition is established that no form of negligence on the part of the insured, or his agents or others, leading to a loss avoids the policy, unless it amounts to a wilful act on the part of the insured." *Id. See also* People v. McNutt, 40 Cal. App. 2d 835, 839, 105 P.2d 657, 659 (1940) (even gross negligence is not wilful misconduct).

103. *E.g.*, Crull v. Gleb, 382 S.W.2d 17, 22 (Mo. Ct. App. 1964). "Therefore, wanton and reckless acts of the insured do not amount, in law, to intentional acts so as to permit an insurer to deny coverage under the provision of a clause, in a liability insurance policy, which provides that it does not provide coverage for injury intentionally caused by insured." *Id.* The United States Court of Appeals for the Fourth Circuit has held: "Negligent conduct may be so gross as to merit characterization as willful and wanton in the sense of the rule for punitive damages, yet fall far short of an assault and battery which would distinguish it from an accidental event and withdraw it from the coverage of the policy. Punitive damages are not limited to assaults and batteries, and the award of such damages does not convert the case into an assault and battery." Pennsylvania T. & F. Mut. Cas. Ins. Co. v. Thornton, 244 F.2d 823, 827 (4th Cir. 1957).

the insured might well contend that his policy providing coverage of all damages included those intended to be punitory.

Furthermore, although section 533 of the Insurance Code purports to exclude from coverage any intentional act, there are numerous exceptions to this rule: (1) those in which the insurance company failed to abide by its contractual duty;[104] (2) workers' compensation cases;[105] (3) instances in which the act was committed by one other than the insured;[106] and (4) cases in which the interpretation of the act as "wilful" was made from the point of view of the injured party.[107] Under these exceptions, cases could arise where the "wilful" act which justified the imposition of punitive damages was within the policy. For example, in two cases, liability for damages arising from intentional torts was held to be covered for collateral reasons relating to the insurance contracts.

In *Tomerlin v. Canadian Indemnity Co.*,[108] the insurer was held liable for damages arising from an assault and battery. The policy specifically excluded any liability for bodily injury sustained as a result of an assault committed by or at the direction of the insured. The insurance company initially agreed to defend the action with a reservation of rights if the assault was found to have been outside the bounds of coverage. But when the complaint against the insured was amended to include counts of negligence, the attorney for the insurance company told the insured that the reservation was a nullity, and the company undertook full defense of the action. This position was reiterated even after the negligence counts were dismissed. Tomerlin, the insured, relying on the attorney's representation, withdrew his own attorney and suffered an adverse judgment. According to the California Supreme Court, the insurer was estopped to deny liability for the final judgment,

104. *See, e.g.*, Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

105. *See, e.g.*, Azevedo v. Abel, 264 Cal. App. 2d 451, 70 Cal. Rptr. 710 (1968).

106. *See, e.g.*, Arenson v. National Auto. & Cas. Co., 45 Cal. 2d 81, 286 P.2d 816 (1955).

107. *See generally* Farbstein & Stillman, *Insurance for the Commission of Intentional Torts*, 20 HASTINGS L.J. 1219 (1969). Determination of wilfulness from the victim's perspective is an approach prevalent in other jurisdictions. *See, e.g.*, Huntington Cab Co. v. American Fid. & Cas. Co., 155 F.2d 117, 119 (4th Cir. 1946); New Amsterdam Cas. Co. v. Jones, 135 F.2d 191 (6th Cir. 1943); Messersmith v. American Fid. Co., 232 N.Y. 161, 165, 133 N.E. 432, 433 (1921). The court in *Huntington Cab Co.* observed: "[T]he overwhelming weight of authority holds that an injury is accidentally received when without the fault of the injured person, it is intentionally inflicted by another." 155 F.2d at 119.

108. 61 Cal. 2d 638, 394 P.2d 571, 39 Cal. Rptr. 731 (1964).

even though based on an intentional tort. The court thus held that the measure of damages for which the insurance company was liable was the amount of the *entire* judgment; however, in this case, no punitive damages were in fact recovered.

Similarly, in *Gray v. Zurich Insurance Co.*,[109] a wrongful refusal to defend resulted in the insurer being held liable for damages arising from an intentional tort. In that case an action was brought by Jones, alleging that Gray, the insured, had committed an assault and battery. The insurer, citing Insurance Code section 533, refused to defend. Gray unsuccessfully argued self defense, and suffered a judgment of $6000 actual damages; no punitive damages were awarded. Gray then brought suit against the insurer on the theory that the defendant had breached its duty to defend. The Supreme Court of California affirmed a trial court decision for Dr. Gray, stating that while the exclusionary clause in the policy provided that *coverage* did not extend to wilful acts, the provisions regarding the duty to defend was unclear. The court thus applied the test of the reasonable expectation of the insured, who would expect the defense to be tendered by the company even if the ultimate judgment was outside the policy. The court pointed out that the determination whether the insured acted wilfully or negligently depended upon the outcome of the very suit the insurance company refused to defend, and that the carrier must defend any suit which potentially seeks damages within the policy provisions. The insurer was held liable for the amount of the entire judgment, plus attorney fees incurred in defending the suit. In both *Tomerlin* and *Gray*, insurers were indirectly required to indemnify for damages arising out of intentional torts, despite section 533 of the Insurance Code.

Other exceptions to section 533 have been established by California courts. In *Azevedo v. Abel*,[110] the insurance company contended that the employer's compensation insurance did not provide coverage for an intentional assault by the employer upon an employee, citing both section 533 of the Insurance Code and section 1668 of the Civil Code.[111] The court held that the statutes were inapplicable, and did "not prohibit insurance against the employer's ordinary liability for disability compensation and medical expense, even when occasioned by his wilful wrong."[112]

109. 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); *see* Crocker, *The Continuing Importance of Gray v. Zurich*, 43 L.A.B. BULL. 239 (1968).

110. 264 Cal. App. 2d 451, 70 Cal. Rptr. 710 (1968).

111. See note 119 *infra*.

112. *Id.* at 458, 70 Cal. Rptr. at 714. CAL. LABOR CODE § 4553 (West 1971)

In *Arenson v. National Automobile & Casualty Insurance Co.*,[113] another exception was established in situations where the tortious act was committed by one other than the named insured. In that case plaintiff had a personal liability policy which excluded acts intentionally caused by or at the direction of the insured. The policy term "insured" was defined to include the named insured, his spouse and any other person under twenty-one in his care. Plaintiff's son started a fire which damaged school property, and the school district obtained a judgment against the plaintiff. The insurance company refused to pay the judgment, contending that the exclusionary clause referred to all those covered by the policy, and that none could recover if the damage was caused intentionally by any member of that class. The court rejected this argument, holding that the policy protected the named insured against liability for intentional injury when committed by another insured, and that section 533 of the Insurance Code was not applicable to a situation where the plaintiff was not personally at fault. This case was later supported by the decision in *Nuffer v. Insurance Co. of North America*,[114] in which the Supreme Court of California held that recovery upon a policy of fire insurance was not defeated by the fact that the loss for which recovery was sought resulted from the intentional arson of the insured's agent.[115]

In addition, California cases have recognized yet another sense in which an act which can be called wilful or intentional may still be

states: "[C]ompensation otherwise recoverable shall be increased one-half where the employee is injured by reason of the serious and willful misconduct of [the employer]." This amount might well be called punitive. Insurance Code section 11661 prohibits insurance covering this additional compensation. The court in *Azevedo* held that Civil Code section 1668 and Insurance Code section 533, if held applicable, would deprive Insurance Code section 11661 of its function, and said, "The employer's inability to insure himself against liability for serious and willful misconduct amply fulfills the public policy banning insurance which tends to encourage willful injury." 264 Cal. App. 2d at 458, 70 Cal. Rptr. at 714.

113. 45 Cal. 2d 81, 286 P.2d 816 (1955).

114. 236 Cal. App. 2d 349, 45 Cal. Rptr. 918 (1965).

115. *Nuffer* involved only the employer's liability for compensatory damages arising from a tort committed by an employee. However, the holding that Insurance Code section 533 does not preclude coverage of such an act has bearing on the issue of vicarious liability for punitive damages as well. It will be urged subsequently that California courts in appropriate instances allow coverage of punitive damages when the insured is only vicariously liable, and that the holding that Insurance Code section 533 does not preclude coverage seems to forestall any public policy argument that the intent and act of the employee should be attributed to the employer to prohibit punitive damage insurance.

within coverage. For instance, in *Meyer v. Pacific Employers Insurance Co.*,[116] the court said:

> The fact that an act which causes an injury is intentional does not take the consquences of that act outside the coverage of a policy which excludes damages unless caused by accident for if the consequence that is the damage or injury is not intentional and is unexpected it is accidental in character.[117]

Although *Meyer* involved waterwell drilling, the court cited as an example an automobile accident. Thus while the act of driving is intentional, an ordinary consequence of which may be an injury to person or property, "certainly no one would contend that an injury occasioned by . . . even reckless driving was not accidental within the meaning of a policy of accident insurance . . . ."[118] California thus seems to have adopted the view that one looks at the event from the point of the injured party—asking whether he has been in an accident.[119] If the event and resultant harm happened unexpectedly and without design on the part of the injured person, the damage is covered by the policy.[120]

Thus, under these various exceptions to section 533 of the Insurance Code, a situation could arise in which the intentional and malicious character of the act would support an award of punitive damages and yet the resultant compensatory damages are within policy coverage. In such a case, the insured might well contend that the punitive award should likewise be covered. However, the case must be one in which:

> 1) The insured's actions are determined to be malicious, or less commonly, fraudulent or oppressive, and thus punitive damages are appropriate under Civil Code section 3294;
>
> 2) The insurer's liability for compensatory damages under the policy is established because the act
>
> a) is malicious but not intentional,

116. 233 Cal. App. 2d 321, 43 Cal. Rptr. 542 (1965).

117. *Id.* at 327, 43 Cal. Rptr. at 547.

118. *Id.*, 43 Cal. Rptr. at 546.

119. *See also* Huntington Cab Co. v. American Fid. & Cas. Co., 155 F.2d 117 (4th Cir. 1946); Richards v. Travelers Ins. Co., 89 Cal. 170, 26 P. 762 (1891).

120. Traditional analysis characterizes acts purposely done in the absence of certainty as to the results as either a form of negligence or as recklessness depending on the probability of the results. *See* RESTATEMENT (SECOND) OF TORTS §§ 282, comment *d* at 500 (1965). *See generally id.* § 8A.

b) although wilful, falls into an exception based on the insurer's wrongful actions,

c) is brought under workers' compensation statutes,

d) was committed by one rather than the named insured, or

e) is based on a characterization of the *results* as accidental although the *act* was deliberate.

Thus, a strict reading of the applicable California statutes suggests that it is theoretically possible for a situation to arise in which the liability of the insurer for punitive damages is at issue. Such would, however, be a rare case, and in fact, the issue has arisen in only one California case, which is discussed in some detail below.

The Status of California Case Law

The only California case to consider whether punitive damages as such could be insured against is *United States Fidelity & Guaranty Co. v. Janich*,[121] decided in 1943 by a California federal court in diversity. In that case the insurance company had issued a policy to the Sanitary Construction & Engineering Co., a partnership. Janich, a partner in the company, while in performance of his work, became embroiled in a dispute with one Berrey and struck him. Berrey sustained personal injuries and, alleging Janich acted maliciously, sued Janich and the other partners for compensatory and punitive damages. The insured partners cross-claimed against their insurance company, arguing that the policy issued by the company designated assault and battery as an accident, and thus the insurer was liable for punitive damages. The court tersely disposed of the issue:

> The [insurer's] motion to strike that portion of the cross-claim relating to exemplary or punitive damages is denied. In Coverage A, [insurer] agrees: "To pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of liability imposed by law. . . ." Such a broad provision would embrace punitive damages.[122]

This case has been cited as one which construes punitive damages as within the contractual language.[123] It is of only limited precedential value in attempting a prediction of California's stand on the issue; the

121. 3 F.R.D. 16 (S.D. Cal. 1943).

122. *Id.* at 19.

123. *See* Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 439 n.15 (5th Cir. 1972).

policy involved contained an exceptionally broad provision unlike policies in use today;[124] the opinion does not explicitly address the public policy issue; the decision was rendered by a federal court which, lacking previous cases on point, could only predict how California courts would handle the issue; and most important, the case involved the liability of a partnership for the act of a partner,[125] a special situation involving a type of vicarious liability.

California's Position on the Public Policy Issue

Even if it is proper to cite *Janich* as authority for the proposition that punitive damages are covered as a matter of construction by an ordinary contract of insurance, the question whether such coverage is contrary to public policy remains to be answered.[126] In the absence of direct authority, the answer lies in analogy. The Supreme Court of California, for example, in both *Tomerlin*[127] and *Gray*[128] discussed the public policy question and found that the purpose behind section 1668 of the Civil Code[129] and section 533 of the Insurance Code is to deter tortious acts by denying the actors the possibility of contracting to shift responsibility for their intentional torts to another. In *Tomerlin*, the court justified its decision to hold the insurer liable in this way:

> Although an insurer may not indemnify against liability caused by the insured's wilful wrong . . . defendant's liability here does not arise from a contract executed prior to plaintiff's wilful misconduct, but from an estoppel which arose *after* it. Section 1668 of the Civil Code and section 533 of the Insurance Code establish a public policy to prevent insurance coverage from encouragement of wilful torts. . . . Recovery under a subsequent estoppel does not offend such public policy.[130]

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124. The policy in use in *Janich* read: "To pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of liability imposed by law . . . ." 3 F.R.D. at 19. In contrast, a more modern policy would read: "To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage." This was the wording at issue in both *Carroway* and *Hills* as well as most other cases discussed herein. See notes 1-2 *supra.*

125. See notes 152-53, 168-70 & accompanying text *infra.*

126. CAL. CIV. CODE § 1668 (West 1973) is pertinent here: "All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law."

127. 61 Cal. 2d 638, 394 P.2d 571, 39 Cal. Rptr. 731 (1964).

128. 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

129. See note 126 *supra.*

130. 61 Cal. 2d 638, 648, 394 P.2d 571, 577-78, 39 Cal. Rptr. 731, 737-38 (1964) (citations omitted). In Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432 (5th Cir. 1962), the insured also argued that the insurance company was estopped to deny

Similarly, in *Gray*, in rejecting the insurer's contention that coverage of the assault and battery would violate public policy under these sections, Justice Tobriner said:

> The contention fails on two grounds. In the first place, the statutes forbid only contracts which indemnify for "*loss*" or "*responsibility*" resulting from wilful wrongdoing. Here we deal with a contract which provides for *legal defense* against an action charging such conduct; the contract does not call for indemnification of the insured if the third party plaintiff prevails. In the second place . . . the statutes "establish a public policy to prevent insurance coverage from encouragement of wilful tort." . . . [A] contract to defend an assured upon mere accusation of a wilful tort does not encourage such wilful conduct.[131]

Thus it is apparent that under section 3294 of the Civil Code the purpose of punitive damages is to punish the wrongdoer. The public policy behind section 1668 of the Civil Code and section 533 of the Insurance Code is one of discouraging tortious acts. These policies are the same as those expressed in *McNulty*, and thus the statement in that case should govern: "Where a person is able to insure himself against punishment he gains a freedom of misconduct inconsistent with the

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liability. The court rejected this argument: "Consistency compels us to hold, however, that since public policy forbids an insurer and an insured to enter into an insurance contract covering punitive damages, public policy forbids the accomplishment of the result by an estoppel." *Id.* at 442. *See also* American Surety Co. v. Gold, 375 F.2d 523 (10th Cir. 1966).

131. 65 Cal. 2d at 277-78, 419 P.2d at 177, 54 Cal. Rptr. at 113. In Ging v. American Liberty Ins. Co., 293 F. Supp. 756 (D. Fla. 1968), the situation involved was similar to that of the California cases here discussed. The plaintiff brought an action charging the defendant insurance company with bad faith and negligence in handling negotiations to settle a claim of the insured. The issue decided by the court was whether an insured could recover the amount of a judgment against him in excess of the limits of the policy on the basis of the insurer's bad faith refusal to settle, where the amount of the excess judgment represented punitive damages. The court held that the insurance company's conduct in declining to accept the offer to settle caused no legally compensable damage to the insured. "The question of the insurer's good or bad faith is never reached, since, with respect to the claim for punitive damages, there was no duty not to act in bad faith . . . ."

"In this Court's opinion, the decision reached here is not only consistent with, but dictated by, the public policy considerations discussed in the *McNulty* opinion. It places the full and final responsibility for reprehensible conduct squarely where it should be—on the shoulders of the actor. Any other rule would allow him to shift at least partial responsibility to his insurer in the guise of suits—such as this—for bad faith refusal to settle." *Id.* at 761-62.

In both *Tomerlin* and *Gray*, the insurer was held liable for the "entire judgment." The insurer might have been held responsible for punitive damages if the judgment had included such an award. In neither case were punitive damages recovered in fact, but the reasoning in *Ging* does seem more consistent with the underlying rationale of public policy.

establishment of sanctions against such misconduct."[132] These considerations would appear to require the California courts to carry their established public policy argument to its logical conclusion by placing the financial burden of the punishment (as distinguished from compensatory damages) on the tortfeasor himself. Moreover, this conclusion is also supported by an analogy to California suretyship cases, which establish a clear policy of refusing to impose liability for punitive damages on one other than the actual wrongdoer.

Although suretyship and insurance contracts are clearly distinct, rules of construction and interpretation are similar, as are the underlying functions.[133] Thus, while statutory bonds are construed with reference to the statutes bearing upon them, ordinary undertakings of sureties are private contracts, and are interpreted like any other contract.[134] Given the similarity between surety bonds and insurance contracts, the California rule that a surety is not liable for punitive damages should provide persuasive support for an adoption of an analogous rule excluding punitive damages from an insurance policy.

The limits of the liability of a surety are well established in this state. In *Carter v. Agricultural Insurance Co.*,[135] the defendant was the surety on an attachment bond issued to codefendants, the Palmers, obligating him to pay all costs awarded the plaintiff and "all damages which he may sustain by reason of the attachment, not exceeding the

132. Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 440 (5th Cir. 1962).

133. *See, e.g.*, Klinell v. Shirey, 223 Cal. App. 2d 239, 35 Cal. Rptr. 901 (1963).

134. *See* 46 CAL. JUR. 2D *Suretyship & Guaranty* § 17 (1959). In one California case, the court said: "An attachment bond is in actuality a type of insurance. It is insurance that the defendant in an attachment action will be paid, within the limits of the bond, any damages he sustains by reason of the levy." Klinell v. Shirey, 223 Cal. App. 239, 246, 35 Cal. Rptr. 901, 906 (1963).

135. 266 Cal. App. 2d 805, 72 Cal. Rptr. 462 (1968). The opinion designated the question as one of first impression in California, distinguishing Barlin v. Barlin, 156 Cal. App. 2d 143, 319 P.2d 87 (1957), in which an award including punitive damages against a surety was affirmed, as not raising the question involved in *Carter*, and distinguishing as dicta statements in Klinell v. Shirey, 223 Cal. App. 2d 239, 245, 35 Cal. Rptr. 901, 906 (1963). *See also* Arnold v. State *ex rel.* Burton, 220 Ark. 25, 245 S.W.2d 818 (1952); Yesel v. Watson, 58 N.D. 524, 226 N.W. 624 (1929); United States Fire Ins. Co. v. McDaniel, 408 S.W.2d 134 (Tenn. App. 1966); 6 AM. JUR. 2D *Attachment and Garnishment* § 635 (1971). *Contra*, State *ex rel.* Coffelt v. Hartford Acc. & Indem. Co., 44 Tenn. App. 405, 314 S.W.2d 161 (1958); Garner v. State *ex rel.* Askins, 37 Tenn. App. 510, 266 S.W.2d 358 (1953). Section 190 of the *Restatement of Security* provides: "The liability of a surety on an attachment bond extends within the penal limits of the bond to all loss sustained by the defendant in consequence of a wrongful attachment including reasonable expense incurred by the defendant in procuring a dissolution of the attachment, but does not include exemplary damages which may be recovered against the plaintiff for malicious prosecution or other reasons."

sum specified in the undertaking."[136] The plaintiff Carter brought suit for a wrongful and malicious attachment; the trial court awarded him compensatory and punitive damages amounting to a sum well within the limits of the bond. The plaintiff insurance company appealed the judgment, protesting its liability for a punitive award. The court resolved the issue by examining the pertinent code:

> The issue here may be resolved by statutory construction of the words all damages *sustained by* the attachee. The attachee does not sustain punitive or exemplary damages. These are imposed on the attachor as punishment for his malice. . . . We hold an undertaking to secure those obligations set forth in the Code of Civil Procedure, section 539 does not obligate a surety to pay punitive or exemplary damages imposed for malicious attachment.[137]

In Tennessee, which has upheld coverage of punitive damages,[138] suretyship cases are contrary to those of California. Judge White, in *Lazenby*,[139] felt the analogy between insurance and suretyship was close enough to allow this policy to operate as support for holding the insurer liable for punitive damages levied against the insured.[140] Hence, a jurisdicition holding contrary to Tennessee on surety liability might also hold contrary to Tennessee on the question of coverage for puntive damages under an insurance policy.[141]

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136. 266 Cal. App. 2d 805, 806, 72 Cal. Rptr. 462, 464 (1968), *quoting* CAL. CODE CIV. PROC. § 539 (West 1954).

137. 266 Cal. App. 2d 805, 807, 72 Cal. Rptr. 462, 464 (1968). *See also* Ross v. Sweeters, 119 Cal. App. 716, 724, 7 P.2d 334, 338 (1932). "[W]here the sheriff and his bondsmen would be liable for compensatory damages they would not be liable for punitive or exemplary damages unless they had knowledge of the conduct of the agent and had acquiesced in or ratified his actions." *Id.*

138. See notes 56-57 & accompanying text *supra.*

139. Lazenby v. Universal Und. Ins. Co., 214 Tenn. 639, 383 S.W.2d 1 (1964) (concurring opinion).

140. *Id.* at 653-54, 383 S.W.2d at 8.

141. In Southern Farm Bureau Cas. Ins. Co. v. Daniel, 246 Ark. 849, 440 S.W.2d 582 (1969), the court found the insurer liable for punitive damages, distinguishing an earlier Arkansas case, *Arnold v. State ex rel. Burton*, on the ground that damages in *Arnold* had been governed solely by statute. Judge Fogleman registered a strong dissent, arguing that *Arnold* should control and citing language from that opinion: "Punitive damages are imposed to punish the wrongdoer, not to compensate the plaintiff for the officer's breach of duty. It is therefore generally held that the surety is not liable for punitive damages unless the statute so provides." *Id.* at 861, 440 S.W.2d at 588, *quoting* Arnold v. State *ex rel.* Burton, 220 Ark. 25, 27-28, 245 S.W.2d 818, 819 (1952). Fogleman continued: "The false imprisonment was clearly a breach of that bond, so there was just as much justification for recovery of the punitive damages from the surety as there is for recovery from appellant here." *Id.* at 861-62, 440 S.W.2d at 588; *cf.* Maryland Cas. Co. v. Baker, 304 Ky. 296, 200 S.W.2d 757 (1947), holding that decisions relieving sureties on official bonds from liability for punitive damages were not in point, since in such cases the bond required only that the surety compensate the party for actual damages. *See also* Gonsoulin, *Is an Award of Punitivie Damages Covered*

A Necessary Exception: Insurance for Punitive Damages in Cases of Vicarious Liability

In the foregoing discussion of insurance coverage for punitive damages, the cases have involved a tortfeasor seeking recovery from his insurance company for the penalty attached to his misdeed. Because of his personal involvement, jurisdictions denying coverage have reasoned that it is violative of public policy to allow the actor to escape the punitory consequences of his tort.[142] However, when an element of vicarious liability is added, the equities shift—the insured is held responsible by the injured party for an act he did not commit, and seeks reimbursement from his insurer for a judgment of punitive damages against him for the tort of his servant. Of those states which have faced this issue, all but one have allowed insurance coverage of the award.[143] This section will explore insurance coverage of punitive damages in the context of the vicarious liability of individual employers, partnerships, and corporations. The analysis will first briefly cover the holding as established in other jurisdictions, and then will examine the California law in this area.

Liability for Punitive Damages: Individual Employers

The leading case establishing a policy of coverage in a case involving vicarious liability is *Ohio Casualty Insurance Co. v. Welfare Finance Co.*[144] In this case, an action was brought against the insured for

Under an Automobile or Comprehensive Liability Policy? 22 SW. L.J. 433 (1968); Comment, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517 (1957).

142. See notes 51-55 & accompanying text *supra*.

143. *See* Southern Farm Bureau Cas. Ins. Co. v. Daniel, 246 Ark. 849, 440 S.W.2d 582 (1969); Sterling Ins. Co. v. Hughes, 187 So. 2d 898 (Fla. Ct. App. 1966); Commercial Union Ins. Co. v. Reichard, 404 F.2d 868 (5th Cir. 1968) (applying Florida law); Scott v. Instant Parking, Inc., 105 Ill. App. 2d 133, 245 N.E.2d 124 (1969); Continental Ins. Cos. v. Hancock, 507 S.W.2d 146 (Ky. Ct. App. 1973); Ohio Cas. Ins. Co. v. Welfare Fin. Co., 75 F.2d 58 (8th Cir. 1934) (applying Missouri law), *cert. denied*, 295 U.S. 734 (1935); Esmond v. Liscio, 209 Pa. Super. 200, 224 A.2d 793 (1966) (dicta); General Cas. Co. of America v. Woodby, 238 F.2d 452 (6th Cir. 1956) (applying Tennessee law); *cf.*, Glen Falls Indem. Co. v. Atlantic Bldg. Co., 199 F.2d 60 (4th Cir. 1952). It should be noted that Illinois and Arkansas have addressed the issue of insurance coverage for punitive damages only in the vicarious liability context. *Cf.* United States Fid. & Guar. Co. v. Janich, 3 F.R.D. 16 (S.D. Cal. 1943). *But see* Universal Indem. Ins. Co. v. Tenery, 96 Colo. 10, 39 P.2d 776 (1934), in which the policy was issued to the Hertz rental system, to cover renters of cars. One Callahan rented a car, and while intoxicated, caused a collision injuring the plaintiff. The court rejected any liability of the insurer for insuring punitive damages. Under similar facts, the Idaho Supreme Court found coverage of the punitive damages, but did not base its decision on the vicarious liability issue. Abbie Uriguen Olds. Buick, Inc. v. United States Fire Ins. Co., 95 Idaho 501, 511 P.2d 783 (1973).

144. 75 F.2d 58 (8th Cir. 1934), *cert. denied*, 295 U.S. 734 (1935).

damages sustained by one Dauster caused by an act of the insured's servant. The injured party prayed for a punitive award in addition to compensatory damages, claiming that the act was done "in a reckless disregard of plaintiff's rights and safety."[145] The action was settled for $9000, and the insured subsequently brought suit against the insurance company to recover $5000 pursuant to the insurance company's stipulation that it was liable for this sum if it was determined that the policy covered punitive damages. The insurance company argued that the terms of the policy did not cover punitive damages, and that, even if they did, such coverage would be contrary to public policy. The court acknowledged that a grave question of validity would arise if one tried to protect himself from the consequences of his wilful acts, "since it might well be said that it would be against public policy to permit a person to protect himself in advance against the consequences of intentional wrongdoing injurious to others."[146] But the court distinguished the instant case wherein the *sole* liability of the insured was predicated upon the relationship of master and servant:

> If the master participates in, authorizes, or knows in advance that his servant will probably commit the unlawful injurious act, then the situation may be analogous to where the insured himself commits an intentional act with an intended injury and the same reasons for holding a protecting policy invalid as to such acts would exist. . . . In this situation where there was no direct or indirect volition upon the part of the master in the commission of the act, no public policy is violated by protecting him from the unauthorized and unnatural act of his servant.[147]

However, this extension of coverage to vicarious liability situations will not be an issue in every case. Many states, including California,[148] do not allow an award of punitive damages against one whose liability is only vicarious; in these jurisdictions the question of vicarious liability for punitive damages does not arise, as punitive damages are assessed against the master only when he participates in, authorizes, or ratifies the act.[149] In such cases liability must be personal before puni-

145. *Id.*

146. *Id.* at 60.

147. *Id.*; *accord*, Southern Farm Bureau Cas. Ins. Co. v. Daniel, 246 Ark. 849, 852, 440 S.W.2d 582, 584 (1969). "[W]e can perceive of no good reason why an employer should be prohibited from insuring himself against such losses, since the losses are in effect a business loss—i.e. a calculated risk of doing business." 242 Ark. at 852, 440 S.W.2d at 584. "Public policy is not violated by insurance in such a situation anymore than it would be if a newspaper took out insurance for libel." Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 440 (5th Cir. 1962).

148. See notes 162-64 & accompanying text *infra*.

149. *See* 22 AM. JUR. 2D *Damages* § 258 (1965).

tive damages can be assessed, and coverage would be decided pursuant to the theories previously discussed.[150] Other states, however, permit assessment of punitive damages against the employer whenever the employee-tortfeasor has acted within the scope of his employment, that is, whenever the employer would be liable for compensatory damages under the doctrine of respondeat superior.[151] Having thus expanded the master's liability for punitive damages, the courts then have allowed him to pass along such liability to his insurance company.

Liability for Punitive Damages: Partnerships

In a partnership situation, only one case outside California discusses insurance for punitive damages. In *Malanga v. Manufacturer's Casualty Insurance Co.*,[152] a comprehensive liability policy was issued to a partnership. Under the policy the defendant insurer undertook "to pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury . . . caused by accident."[153] Assault and battery was designated an accident unless committed by or at the direction of the insured. One of the partners committed an assault and battery on a third party, who sued the partnership and won a jury verdict which included punitive damages. When the insurer refused to satisfy the judgment, the partnership brought suit. The court held that the assaulting partner was excluded from coverage since as to him the assault was not an accident (and thus he would be liable to the insurer under subrogation),

150. See notes 51-66 & accompanying text *supra*.

151. *See* 22 AM. JUR. 2D *Damages* § 261 (1965). Most states have spoken only regarding vicarious liability between master and servant or corporation and employee. However, Florida has recently extended coverage for punitive damages under vicarious liability to a situation in which the owner of an automobile was held liable for the act of the driver. In Travelers Ins. Co. v. Wilson, 261 So. 2d 545 (Fla. Ct. App. 1972), the Wilsons had sustained injuries in a collision with a vehicle owned by Miller and operated by Johnston, and they sued both of them for punitive and compensatory damages. There was no allegation of an employer-employee relationship. The court did not pass on the correctness of the lower court's holding that an owner's vicarious liability would subject him to punitive damages for the gross negligence of one to whom he had entrusted the vehicle. The court addressed itself only to the question whether, assuming vicarious liability rendered the owner liable, the owner was covered for a punitive award by his insurance policy. It held: "[I]f punitive damages are assessed against Miller solely on the basis of vicarious liability arising out of ownership, and not because of any active wrongdoing or misconduct on his part which would itself justify imposition of punitive damages, then such damages are within the insuring agreement of appellant's policy . . . ." *Id.* at 548.

152. 28 N.J. 220, 146 A.2d 105 (1958).

153. *Id.* at 223, 146 A.2d at 106.

but that coverage would extend to the partnership entity unless the assault could be said to have been committed at the direction of the partnership. The insurer argued that insurance coverage was contrary to public policy because the act, perpetrated in the course of partnership business, was that of the partnership. The court rejected this contention, distinguishing between the act of the agent and the liability of the principal, and held that the partnership entity, distinct from its members, was entitled to the indemnity which it had purchased.

Liability for Punitive Damages: Corporations

Early cases on corporate liability held that torts of an agent were personal wrongs of the employee, and not torts of the corporation, reasoning that a corporation could not do an act unauthorized by its charter.[154] This doctrine was soon repudiated,[155] and a corporation is now clearly held liable for compensatory damages arising from the acts of its agents committed within the scope of employment.[156] At one time it was also held that a corporation would not be liable for a tort involving intent or malice as an essential element, but even this limitation no longer exists.[157] Some states, including California, hold the corporate entity liable for punitive damages only upon a showing of participation in, or authorization or ratification of the act by one representing the corporation.[158] In an equal number of states, the rule is that a corporation is responsible for punitive damages for any act of its agent or servant within the scope of employment which would subject the employee himself to punitive damages, whether or not that act was authorized or ratified by the corporation.[159] Regardless of the theory under which a corporation can be held liable for punitive damages, insurance seems intuitively to be a desirable way to prevent the

154. *E.g.*, Orr v. Bank of the United States, 1 Ohio 37, 13 Am. Dec. 588 (1823).

155. *See, e.g.*, Hussey v. King, 98 N.C.34, 3 S.E. 923 (1887); Standard Oil Co. v. State, 117 Tenn. 618, 100 S.W. 705 (1907). In one case, the court said, "Of course, no corporation can lawfully authorize the doing of an unlawful act, or of a tortious or negligent act. Neither can an individual acquire a right to commit a tort; but the absence of the right to do that which is wrong will not absolve him from the consequences of the wrong." Clinchfield Fuel Co. v. Henderson Iron Works Co., 254 F. 411, 416 (5th Cir. 1918).

156. *See generally* 19 C.J.S. *Corporations* § 1285 (1940).

157. *See* Philadelphia, W. & B.R.R. v. Quigley, 62 U.S. (21 How.) 202 (1858); Goodspeed v. East Haddam Bank, 22 Conn. 529 (1853).

158. *See generally* 22 AM. JUR. 2D *Damages* § 258 (1965).

159. *Id.* § 261. For a collection of cases from both types of states, see Note, *The Assessment of Punitive Damages Against an Entrepreneur for the Malicious Torts of his Employees*, 70 YALE L.J. 1296 (1961).

ultimate imposition of a punitive award on the innocent shareholders of the enterprise. Illinois is the only state to have considered the insurability of corporate liability for punitive damages, and has allowed insurance coverage for a punitive award against the corporation.[160] In *Scott v. Instant Parking, Inc.*, the court said, "There is no reasonable basis to declare the latter type of insurance is against public policy."[161]

California's Position on Vicarious Liability

In California, a recent case, *Hale v. Farmer's Insurance Exchange*,[162] stated that a principal's liability for punitive damages resulting from his agent's acts conformed to that set forth in section 909 of the *Restatement of Torts*. This section would allow punitive damages against a principal because of the act of an agent if but only if:

> (a) the principal authorized the doing and the manner of the act, or
>
> (b) the agent was unfit and the principal was reckless in employing him, or
>
> (c) the agent was employed in a managerial capacity and was acting within the scope of employment, or
>
> (d) the employer or a manager of the employer ratified or approved the act.[163]

In the case of a master-servant relationship, where the servant is not employed in a managerial position, California follows a narrow rule, forbidding liability for punitive damages from being imposed upon a principal in the absence of proof of some actual culpability on his part.[164] But such culpability is satisfied by a showing of participation,

160. Scott v. Instant Parking, Inc., 105 Ill. App. 2d 133, 245 N.E.2d 124 (1969); *cf.* Glen Falls Indem. Co. v. Atlantic Bldg. Corp., 199 F.2d 60 (4th Cir. 1952). In *Glen Falls*, a jury gave a verdict against the defendant insured for $250 actual damages and $2,500 punitive damages. The case was then settled for $2,700, and the court held the insurance company liable for the entire amount.

161. Scott v. Instant Parking, Inc., 105 Ill. App. 2d 133, 137, 245 N.E.2d 124, 126 (1969).

162. 42 Cal. App. 3d 681, 691, 117 Cal. Rptr. 146, 153 (1974). In *Hale* the court said, "While an employer may be liable for an employee's tort under the doctrine of respondeat superior, he is not responsible for punitive damages where he neither directed nor ratified the act." *Id.* at 690, 117 Cal. Rptr. at 153.

163. *Id.* at 691, 117 Cal. Rptr. at 153.

164. *See* Deevy v. Tassi, 21 Cal. 2d 109, 130 P.2d 389 (1942); Evans v. Gibson, 220 Cal. 476, 31 P.2d 389 (1934); Ebaugh v. Rabkin, 22 Cal. App. 3d 891, 99 Cal. Rptr. 706 (1972); Weber v. Leuschner, 240 Cal. App. 2d 829, 50 Cal. Rptr. 86 (1966). Of course, the master is liable for compensatory damages under respondeat superior, and the fact that the agent's act was intentional will not remove the act from coverage under the master's policy. See notes 110-14 *supra*.

authorization or ratification. The rationale for this rule was expressed long ago in *Davis v. Hearst*:[165]

> Since the *animus malus* must be shown to exist in every case before an award in punitive damages may be made against a defendant, since the evil motive is the controlling and essential factor which justifies such an award, it follows of necessity that no principal can be held in punitive damages for the act of his agent, unless the particular act comes within the principal's specific direction or general suggestions, or unless the principal has subsequently ratified it; such ratification presupposing, it is said, original authorization.[166]

Under this narrow California rule, the question of whether a principal's insurance covers punitive damages resulting from the act of his agent would not arise, since the master would not in any event be liable for punitive damages unless he himself was in some measure culpable. And, as has been discussed,[167] where he is a joint tortfeasor by means of his authorization or ratification, section 533 of the Insurance Code and section 1668 of the Civil Code would preclude insurance for the punitive award. Thus, if California were to adopt the principle of non-coverage for punitive damages, as advocated by *McNulty*, there would be no need for an exception for vicarious liability in the ordinary master-servant situation.

As for partnership liability for punitive damages, *United States Fidelity & Guaranty Co. v. Janich*[168] is the only California case in this field, and provides an example of partnership insurance for a punitive award. A wrongful assault and battery by Janich, a partner in the insured firm, was held to be covered by the partnership policy which designated assault and battery an accident. Although the vicarious liability issue was not litigated,[169] punitive damages were imposed on the partnership for the act and held by the court to be covered by the policy. By this coverage, the innocent partners were protected from liability for the unauthorized act. This holding is reasonable. There seems to be no public policy barrier to insurance coverage in favor of the partnership entity.[170]

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165. 160 Cal. 143, 116 P. 530 (1911). For similar rules in other states see Comment, *The Doctrine of Exemplary Damages in its Application to Corporations*, 9 MICH. L. REV. 337, 338 (1911).

166. 160 Cal. 143, 164-65, 116 P. 530, 540 (1911).

167. See notes 91, 126 & accompanying text *supra*.

168. 3 F.R.D. 16 (S.D. Cal. 1943).

169. Coverage here was found under a construction of the policy. *Id.* at 19.

170. Although the opinion made no mention of Janich's own liability, it would seem that he, as the tortfeasor, ought not to profit from the insurance coverage. In the only other partnership case on point, the court held the assaulting partner was excluded from coverage. Malanga v. Manufacturer's Casualty Ins. Co., 28 N.J. 220, 146 A.2d 105 (1958). See text accompanying notes 152-53 *supra*.

Where the employee is acting as a "manager" in a master-servant relationship, and especially in a corporate setting, liability of the employer for punitive damages in California is more expansive than in a simple master-servant situation, in accordance with section 909(c) of the *Restatement of Torts*.[171] Comment *a* to this section states the rationale for such liability:

> Although there has been no fault on the part of a corporation or other employer, where a person acting in a managerial capacity either does an outrageous act or approves of such an act by a subordinate, the imposition of punitive damages upon the employer serves as a deterrent to the employment of unfit persons for important positions.[172]

Thus, under California law, a corporation is liable for both compensatory and punitive damages assessed against a corporate official acting within the scope of his employment. Because of his rank, such an official's act and wrongful intent are imputed to the corporation.[173] For example, as early as 1897 the California Supreme Court in *Maynard v. Fireman's Fund Insurance Co.*[174] declared:

> The Directors are the chosen representatives of *the corporation*, and constitute . . . to all purposes of dealing with others, *the corporation*. What they do within the scope of the objects and purposes of the corporation, the corporation does. If they do an injury to another, even though it necessarily involves in its commission a malicious intent, the corporation must be deemed by imputation to be guilty of the wrong, and answerable for it, as an individual would be in such a case.[175]

Even where the act complained of is performed by a menial servant, the corporation is held liable for punitive damages when such act was done with the knowledge or under the direction of a corporate official having power to bind the corporation.[176] Where high level manage-

171. See note 162 & accompanying text *supra*.

172. RESTATEMENT (SECOND) OF TORTS § 909 (Tent. Draft No. 19, 1973).

173. *See, e.g.*, Pacific Tel. & Tel. Co. v. White, 104 F.2d 923 (9th Cir. 1939); Lowe v. Yolo County Consol. Water Co., 157 Cal. 503, 108 P. 297 (1910); Maynard v. Fireman's Fund Ins. Co., 34 Cal. 48 (1867).

174. 34 Cal. 48 (1867).

175. *Id.* at 57. *See also* Sterling Ins. Co. v. Hughes, 187 So. 2d 898, 900 (Fla. Ct. App. 1966) (dissenting opinion).

176. *See* Alterauge v. Los Angeles Turf Club, 97 Cal. App. 2d 735, 218 P.2d 802 (1950); McInerney v. United R.R., 50 Cal. App. 538, 195 P. 958 (1920). In *McInerney*, the court said, "[I]t is undoubtedly the law that a corporation may become liable in exemplary damages where an act of one of its employees, done in ill will or in actual malice . . . is done with the knowledge or under the express direction of its superior officials having power to bind the corporation, or, if done without such knowledge or direction, is thereafter ratified by such officials, with full knowledge as to the willful and malicious quality of such acts . . . ." *Id.* at 549, 195 P. at 962.

ment has knowledge of the tortious act, corporate responsibility is established.[177]

Should Corporations Be Able To Insure for Punitive Damages Assessed Against Them? A Proposed New Rule

We have seen that in many states, punitive damages can be assessed against an employer even when the employer is not involved in the tortious act of an employee. Furthermore, in all states, an employer—especially a corporate employer—can be liable for punitive damages when an employee with managerial authority commits a tort in the scope of his employment.

Insurability of punitive damages is an issue particularly complex in the context of corporate liability. It is tempting to say that since a corporation can only act through its agents, a corporation can only act vicariously, and thus should always be able to insure itself as an entity against acts committed by any of its agents. One commentator has argued that, since corporate structure entails division of management and ownership with the result that financial liability for torts of the management ultimately rests on the innocent shareholders, corporations should never bear the brunt of punitive damages.[178] If this argument is to be accepted, it could be further argued that corporations should be freely allowed to insure themselves against punitive damages, since it is not inconsistent with public policy to allow insurance where a defendant's liability is merely vicarious, and not the result of personal wrongdoing.[179]

Such a position overlooks two very fundamental arguments. First, embedded in the law is the notion that when an employer authorizes, ratifies or participates in an act of an employee for which he can be assessed punitive damages, that employer is just as liable for punitive damages as is the employee.[180] An employer should not be able to escape the impact of this basic principle merely by incorporating himself. If a corporation reaps the benefits of acts of corporate officers done on behalf of the corporation, it seems only fair that the corpora-

177. Toole v. Richardson-Merrell Inc., 251 Cal. App. 2d 689, 60 Cal. Rptr. 398 (1967).

178. Note, *The Assessment of Punitive Damages Against an Entrepreneur for the Malicious Torts of his Employees*, 70 YALE L.J. 1296 (1961).

179. See notes 142-61 & accompanying text *supra*.

180. *See, e.g.*, Davis v. Hearst, 160 Cal. 143, 240 P. 530 (1911); RESTATEMENT (SECOND) OF AGENCY § 217C (1958); RESTATEMENT (SECOND) OF TORTS § 909 (Tent. Draft No. 19, 1973).

tion accept responsibility when that officer commits a tort in the hope that this corporation will be benefited. Second, such a position overlooks the *McNulty* argument that insurance dissipates the deterrent effect of punitive damages. In fact, given the enormous corporate wealth and power in America, a policy of deterrence as to corporations seems especially vital.

On the other hand, where corporate liability is genuinely vicarious, equity demands that a corporation be treated no differently from an individual (such as an employer) who has been assessed punitive damages through respondeat superior. Where an individual has been allowed to insure himself against vicarious liability for punitive damages, it is only fair that a corporation be likewise able to insure itself on behalf of its innocent shareholders.[181] Thus, in order to assure an equitable solution allowing for maximum corporate insurability consistent with the long standing public policy against encouraging tortious conduct, the following rule is proposed:

> Corporations should be able to insure themselves against liability for punitive damages when the insurance company, through subrogation, would be able to recover an indemnity from the corporate agents who originally caused the corporation to incur the liability.

Such a rule is based on the theory that all liability-causing acts of corporate agents—and it is to be remembered that a corporation can act only through its agents—are divisible into two classes. One class involves acts in the scope of employment for which corporations, like any employer, are liable by operation of law.[182] The second class of liability-causing acts are managerial in nature, usually done specifically to benefit the economic fortunes of the corporation. Since it has been held that the act of a manager is the act of the corporation,[183] this latter class ordinarily should be the corporate equivalent of an employer's personal involvement in a tort. For such personal involvement an

181. A shareholder's power of management is strictly limited both legally and effectively. *See e.g.*, H. BALLANTINE, CORPORATIONS §§ 42-43 (rev. ed. 1946); A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 153-206 (1932). For this reason it can be said that a shareholder has not participated in the tort; hence, to place the burden of the penalty upon the shareholder seems to violate the established tenet that guilt is personal. *See* Lake Shore & M. No. Ry. v. Prentice, 147 U.S. 101 (1893).

182. *See* Evans v. Gibson, 220 Cal. 476, 31 P.2d 389 (1934); New York Cent. & H.R.R.R. v. United States, 212 U.S. 481 (1909); Maynard v. Fireman's Fund Ins. Co., 34 Cal. 48 (1867); RESTATEMENT (SECOND) OF AGENCY § 219(1) (1958).

183. *See* Lowe v. Yolo County Water Co., 157 Cal. 503, 108 P. 297 (1910); Maynard v. Fireman's Fund Ins. Co., 34 Cal. 48 (1867).

individual employer would be liable for punitive damages,[184] and should not be able to insure against the risk; corporations should be no different. The rule proposed above is designed to provide an easy guide for distinguishing those situations in which a corporate entity is "personally" involved in a tort from those in which it is only involved because an employee has committed what could be loosely called an "unauthorized" tort.

This rule has its complexities. Punitive damages imputed to the corporation because of a nonmanagerial tortious act are a risk that should be insurable under the theory of vicarious liability,[185] but punitive damages stemming from certain managerial acts should also be insurable risks. Before these complexities are explored, however, there should be a brief discussion of the principle of subrogation.

Subrogation entitles the insurer, upon payment to the insured, to sue anyone against whom the insured had a cause of action.[186] In other words, the insurance company steps into the shoes of the insured and, in actions against those liable to the insured, is entitled to the same rights[187] and is subject to the same defenses as the insured.[188] Thus, under this proposed rule, insurability of punitive damages assessed against the corporation depends upon whether the agent committing the tort violated a duty to the corporation. If a duty was violated, the corporation has a cause of action against the employee; if the corporation has a cause of action, the insurance company can sue in subrogation; where the insurance company can sue in subrogation, insurability of corporate punitive damages should be allowed.

To illustrate the equities of such a rule, its application in several situations will be posed. Assume first that a corporate employee charged with only ministerial duties commits, in the scope of his employment, the kind of tort for which not only he but also his employer can be assessed punitive damages. Assume further that the injured victim joins both the employee and the employer, winning a

184. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 909 (Tent. Draft No. 19, 1973). See text accompanying note 147 *supra*.

185. See notes 143-47 & accompanying text *supra*.

186. Standard Marine Ins. Co. v. Scottish Metropolitan Assurance Co., 283 U.S. 284 (1931); Hartford Fire Ins. Co. v. Chicago, M. & St. P. Ry., 175 U.S. 91 (1899); Hardware Mut. Ins. Co. v. Dunwoody, 194 F.2d 666 (9th Cir. 1952).

187. Hartford Fire Ins. Co. v. Chicago, M. & St. P. Ry., 175 U.S. 91 (1899); Wager v. Providence Ins. Co., 150 U.S. 99 (1893).

188. Royal Indem. Co. v. Federal Reserve Bank, 38 F. Supp. 621 (S.D. Ohio 1939), *aff'd*, 119 F.2d 778 (6th Cir. 1941); Royal Indem. Co. v. Security Truck Lines, 212 Cal. App. 2d 61, 27 Cal. Rptr. 858 (1963).

punitive damage award for which both parties are jointly liable. Insurance coverage for punitive damages in such a case would not violate public policy, since the employer in such a situation is not personally guilty of socially outrageous behavior.[189] In such a situation, the employee who committed the tort has violated a duty of care which by law he owes to his employer.[190] If the employer is a corporation, the insurance company covering the risk would theoretically have a cause of action in subrogation against the employee. Thus, insurance for punitive damages should be allowed; the insurance company covering the loss would be able to pass the ultimate burden of the punitive damages back to the employee, and the penalty would settle upon the most blameworthy party. The *McNulty* doctrine of deterrence is admirably served by this; the innocent corporate employer is not ultimately liable for the penalty, while the actual tortfeasor is not only liable for the punitive damages in the original action filed against him by the injured party, but is also faced with a second action against him in subrogation for whatever part of that award the corporate employer was forced to assume. Thus, the party to blame for the tort is even more likely to be deterred from such conduct.[191]

Second, let us shift our attention to the corporate board room where various corporate officers and directors with managerial authority are considering the wisdom of a proposed business transaction with a third party. The proposition is potentially fraudulent, and corporate managers weigh the decision carefully. They decide that, although certain risks attend the scheme, the chance for huge corporate gain outweighs the chance of incurring civil liability for the fraud. The

189. Note, however, that California at least has adopted the view that a principal is liable for punitive damages if the agent was unfit and the principal was negligent in hiring him. *See* Hale v. Farmers Ins. Exch., 42 Cal. App. 3d 681, 117 Cal. Rptr. 146 (1974), *quoting* RESTATEMENT (SECOND) OF TORTS § 909 (Tent. Draft No. 19, 1973). *See also* RESTATEMENT (SECOND) OF AGENCY §§ 213, 217C (1958).

190. RESTATEMENT (SECOND) OF AGENCY §§ 377, 400-01 (1958).

191. Officers of a corporation are liable to it when they are guilty of a breach or neglect of any duties owing by them to the corporation which proximately results in a loss to the corporation. *See, e.g.*, Wallach v. Billings, 277 Ill. 218, 155 N.E. 382 (1917), *cert. denied*, 244 U.S. 659 (1917); ABA MODEL BUS. CORP. CODE ANN. 2D § 48, ¶ 1 (1971 & Supp. 1974). However, management rarely enforces the corporation's right to indemnity from an insider. *See* Bishop, *New Cure for an Old Ailment: Insurance Against Directors' and Officers' Liability*, 22 BUS. LAW. 92, 108 & n.65 (1966) [hereinafter cited as Bishop]. Further, the corporation's common law right of indemnity against its employees is eliminated, since the corporation's liability policies usually include as additional assureds the directors, officers and employees of the corporation. *See* Brook, *Officers' and Directors' Liability Insurance*, 2 THE FORUM 228, 232 (1967). However, it seems logical that economic realities would ensure that the insurance company, unlike the corporation, would enforce its right over against the tortfeasor.

transaction is carried out, but the third party, discovering the fraud, joins both the corporate managers and the corporation in an action, winning a judgment of punitive damages for which both the officers and the corporation are liable. Here the corporate managers have violated no duty to the corporation, as they are protected by the "business judgment rule."[192] That rule holds that managerial personnel, in need of free and unhampered discretion to manage a corporation's business affairs, are not liable for financial losses incurred by faulty business judgment unless (1) the managers were negligent in informing themselves of the underlying situation upon which the decision was based,[193] (2) the managers were financially self-interested in the decision,[194] or (3) it was the kind of decision that no reasonable businessman would have made (i.e. waste).[195] The hypothetical situation here presupposes that none of these three elements are present, and therefore no duty to the corporation has been violated. Consequently, there is no cause of action to which the insurance company can be subrogated; to allow insurance of the punitive damages assessed against the corporation would violate public policy, as the tortfeasor would escape any penalty. This application of the rule comports well with *McNulty's* deterrence objective: where the managers are not liable to the corporation, allowing the corporation to pass the cost of the punitive damages to the insurance company would negate any financial incentive for

192. This rule has been described as follows: "If in the course of management, directors arrive at a decision, within the corporation's powers (*intra vires*) and their authority, for which there is a reasonable basis, and they act in good faith, as the result of their independent discretion and judgment, and uninfluenced by any consideration other than what they honestly believe to be the best interests of the corporation, a court will not interfere with internal management and substitute its judgment for that of the directors to enjoin or set aside the transaction or to surcharge the directors for any resulting loss." H. HENN, CORPORATIONS § 242 (2d ed. 1970).

193. It is well established that the rule exempting officers of corporations from liability for mere mistakes and errors of judgment does not apply where the loss is the result of a failure to exercise proper diligence and care. "When courts say that they will not interfere in matters of business judgment, it is presupposed that judgment—reasonable diligence—has in fact been exercised. A director cannot close his eyes to what is going on about him in the conduct of the business of the corporation and have it said that he is exercising business judgment." Casey v. Woodruff, 49 N.Y.S.2d 625, 643 (Sup. Ct. 1944).

194. It is also a cardinal principle that a director cannot make a secret profit out of his official position. *See, e.g.*, Tovrea Land & Cattle Co. v. Linsenmeyer, 100 Ariz. 107, 412 P.2d 47 (1966); Dean v. Shingle, 198 Cal. 652, 246 P. 1049 (1926); Golden Rod Mining Co. v. Bukvich, 108 Mont. 569, 92 P.2d 316 (1939).

195. "[I]f they commit an error of judgment through mere recklessness, or want of ordinary prudence and skill, the corporation may hold them responsible for the consequences." Wangrow v. Wangrow, 211 App. Div. 552, 556, 207 N.Y.S. 132, 136 (1924).

anyone in the corporation to refrain from intentional torts. On the other hand, if the corporation must bear the impact of punitive damages without insurance where no cause of action against the employee exists, then at least there would be internal political pressures—from shareholders, directors, and other officers—to avoid the commission of intentional torts.[196] In addition, where the corporate managers under the protection of the business judgment rule are assessed punitive damages, they can, under many corporate statutes,[197] seek indemnification from the board of directors, under a theory that such losses were incurred in the interest of the corporation and should be borne by it.[198] Certainly when a corporation has so indemnified a director, it has, as an entity, ratified the tortious act and should thus be considered, in a manner of speaking, institutionally guilty of wrongdoing. But even where an indemnification is not actually made, the ability of a corporation to indemnify is itself evidence that the tortious act is attributable to the corporation in a way that a nonmanagerial tort is not. In short, a managerial tort attempted for the benefit of the corporation needs to be deterred. Insurance covering resultant punitive damages—when imposed directly upon the corporation or even when liability is voluntarily assumed under the indemnification statutes—should be against public policy.

Third, assume that the corporate managers described above acted negligently or in their own interests, and hence did not come under the aegis of the business judgment rule. Since these managers have violated a duty of care or loyalty to the corporation, the corporation could bring an action against these managers to recover all losses proximately caused. Thus, an insurance company in subrogation could establish its cause of action, and insurance for punitive damages should be allowed. Under these facts, it could be said that the corporation has been victimized by the very persons, the managers, upon whom the shareholders place the most trust. Civil liability and punitive damages imposed on the corporation here were not incurred in pursuit of cor-

196. One great incentive to avoid incurring civil liability is the fact that such losses must often be entered on the corporate balance sheets as special items of loss. Such a special balance sheet entry might cause directors and shareholders to take a special note of the managers' wrongful activity. But if in the same breath corporate managers could boast that the loss because of punitive damages was largely offset by insurance, much of the beneficial outrage from shareholders and directors would be lost.

197. *See, e.g.*, CAL. CORP. CODE § 317(i) (West Supp. 1976) (effective Jan. 1, 1977); DEL. CODE ANN. tit. 8, § 145 (1974); ABA MODEL BUS. CORP. ACT ANN. 2D § 5, ¶ 1 (1971 & Supp. 1974).

198. For further discussion, see notes 203-06 & accompanying text *infra*.

porate benefit. Rather they are the product of cynical self-dealing or gross negligence. This is not a situation in which these managers could receive indemnification from the corporation for their personal liability for civil damages and punitive damages. The statutes expressly condition indemnification on good faith and due care on the part of the corporate managers.[199] Insurance coverage for punitive damages has an additional benefit in such a situation. Corporate officers who cause the corporation to incur punitive damages, and who are not protected from liability to the corporation by the business judgment rule may still retain sufficient political power within the corporation to prevent the board of directors from instituting suit against them for breach of their duty of loyalty or care. Thus, absent a shareholder derivative suit, ultimate liability for punitive damages may never be visited upon the corporate agents who are ultimately at fault. On the other hand, an insurance company with subrogation rights would have an important financial incentive to pursue these guilty individuals. Thus, insurance coverage of punitive damages where the business judgment rule does not protect corporate managers may actually increase corporate accountability for intentional torts.

This rule seeks to achieve a balance between two competing interests. Corporations and especially corporate managers should be subject to some form of deterrence to implement the social objective of preventing tortious acts, while innocent shareholders should be allowed some measure of protection against financial liability for which their corporation is only vicariously responsible. It is further submitted that in operation such a rule would have the effect of placing corporations on a parity with other business enterprises currently allowed to protect themselves from nonpersonal liability.

California Corporations

It should be noted that in California the above proposed rule of insurance coverage would have limited applicability. California's statutory policies against imposing purely vicarious punitive damages and against insurance for intentional acts largely precludes any judicial discretion to allow insurance for punitive damages.[200] A potential appli-

199. *See, e.g.*, CAL. CORP. CODE § 317(c) (West Supp. 1976) (eff. Jan. 1, 1977), which requires that the agent "acted in good faith, in a manner . . . believed to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in like position would use under similar circumstances."

200. See notes 86-91 & accompanying text *supra*.

cation of this policy, however, may loom in California's new corporations code.

Under the new code, as under its predecessor,[201] the corporation will be authorized both to indemnify its agents for various liabilities[202] and to purchase insurance to cover amounts paid to corporate agents in indemnification.[203] The new code also authorizes corporations to purchase insurance for their agents to cover other liabilities.[204] Indemnity and insurance for the directors and officers of the corporation is intended to insulate these corporate agents from financial losses imposed upon them for their actions on behalf of the corporation,[205] and nothing in these indemnification statutes seems to preclude coverage of punitive damages for which the officer or director has been held liable.[206]

201. CAL. CORP. CODE § 830 (West 1955).

202. *Id.* § 317(b)-(c) (West Supp. 1976) (eff. Jan. 1, 1977).

203. *Id.* § 317(b)(i).

204. *Id.*

205. *See, e.g.*, Bishop, *supra* note 191; Greenberg & Dean, *Protecting the Corporate Executive: Director and Officer Liability Insurance Reevaluated*, 58 MARQ. L. REV. 555 (1975); *A Forum, Insurance Against Liabilities of Directors and Officers*, 22 REC. ASS'N B.N.Y. 342 (1967); Note, *Liability Insurance for Corporate Executives*, 80 HARV. L. REV. 648 (1967) [hereinafter cited as *Corporate Executives*]; Note, *Indemnification of the Corporate Insider: Directors' and Officers' Liability Insurance*, 54 MINN. L. REV. 667 (1970) [hereinafter cited as *Indemnification*].

206. In a proceeding "other than an action by or in the right of the corporation," the agent can be indemnified by the corporation for fines and judgments. CAL. CORP. CODE § 317(b) (West Supp. 1976); DEL. CODE ANN. § 145(a) (1975). Certain types of actions falling within the scope of indemnification may entail a punitive award. Examples are libel and slander, although defamation is usually excluded under the terms of the policy. Additionally, a director could be made a defendant in an antitrust action involving treble damages. *See A Forum, Insurance Against Liabilities of Directors and Officers*, 22 REC. ASS'N B.N.Y. 342, 353 (1967). Allowing such insurance would seem to raise a question in California under section 533 of the Insurance Code and section 1668 of the Civil Code if the action was intentional, but treble damages at least can be awarded without a showing of intentional wrongdoing, thus eliminating the question of public policy. Assuming the corporation has indemnified its agent for punitive damages, whether the corporation's own indemnification reimbursement insurance covers this will depend initially on the terms of the policy. Currently, several companies offer this type of insurance, but most policies are modeled on that of Lloyd's of London, the prototype. Both reimbursement and officer-director insurance are included in one policy. Usually the corporation pays 90% of the premium, and the insured executive is responsible for the remaining 10%. The policy typically has a deductible of at least $20,000, and a coinsurance clause requiring the insured officer to contribute 5% of the loss sustained. The Lloyd's policy covers an area said to be virtually coextensive with the permissible range of indemnification under statute. *See Corporate Executives, supra* note 205.

Loss is defined as "any amount an [insider] is obligated to pay in respect of his legal liability, whether actual or asserted, for a wrongful act . . . and . . . shall include

However, under the rule proposed in this note, a corporation should not be able to obtain a reimbursement for these amounts from an insurance company. As stated earlier,[207] corporate indemnification of an agent for his liability resulting from an intentional tort verges upon corporate ratification of the act. In California, such an indemnification is purely voluntary on the part of the corporation.[208] Also, indemnification presupposes that the corporate officer breached no duty to the corporation,[209] in which case no subrogation action would be available to the insurance company. Thus, insurance to cover indemnification for punitive damages should be considered in violation of public policy.

Finally, with respect to insurance that corporations can buy on behalf of its agents, it seems clear that California law will not permit coverage for liability resulting from intentional acts.[210] Moreover, insurance coverage for punitive damages in such a case should be held in violation of public policy under the reasoning of the *McNulty* case.

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damages, judgments, settlements, and expenses incurred in the defense of actions, suits, or proceedings and appeals therefrom; provided always that such subject of loss shall not include fines or penalties imposed by law, or other matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed." *Indemnification, supra* note 205, at 686. Insurance policies are construed strictly against the drafter; punitive or treble damages may be legitimately subject to the interpretation that such are imposed by law. *See id.* However, the second clause, excluding matters uninsurable under law, should be taken to exclude only those fines which are uninsurable in a particular jurisdiction. Thus, for example, both in Tennessee, which allows insurance for punitive damages in general, and in New Jersey, which follows a policy of noncoverage but has established an exception for vicarious liability, such an award should be covered by the reimbursement policy. Insurability of treble damages would depend on the purpose such damages are intended to serve. It has been argued that such damages are intended to compensate for various uncalculated damages, that they are punitory in impact, and that their dominant purpose is to encourage injured parties to bring suit, an objective which promotes compensatory and punitive aspects. Commissioner v. Obear-Nestor Glass Co., 217 F.2d 56, 61-62 (7th Cir. 1954), *cert. denied*, 348 U.S. 982 (1955) (punitory impact); Julius M. Ames Co. v. Bostitch, Inc., 240 F. Supp. 521, 525 (S.D.N.Y. 1965) (encouraging suits); Vold, *Are Three-fold Damages Under the Anti-Trust Act Penal or Compensatory*? 28 KY. L.J. 117 (1940) (compensation for uncalculated damages). One policy on the market, the American Home Policy, specifically excludes such damages. *See* Bishop, *supra* note 191, at 109 n.66. For further discussion of this subject, see *id.*; Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078 (1968); Brook, *Directors' Indemnification and Liability Insurance*, 21 N.Y.L.F. 1 (1975); *Corporate Executives, supra* note 205; *Indemnification, supra* note 205.

207. See notes 197-98 & accompanying text *supra*.

208. "[A] corporation shall have power to indemnify . . . ." CAL. CORP. CODE § 317(b), (c), (i) (West Supp. 1976).

209. See note 199 *supra*.

210. See note 91 & accompanying text *supra*.

Conclusion

It has been shown that American jurisdictions are split on the question of whether a person should be allowed to insure himself against punitive damages. This note has argued that the better position views such insurance as contrary to public policy, which demands that the guilty parties not be able to shift their penalties to insurance companies. States taking this latter view would, however, make an exception for the case in which punitive damages are imputed through respondeat superior to the otherwise blameless employer. Corporate employers pose special complexities in regard to this exception, and in order to aid in determining instances of institutional guilt, this note has proposed a rule to distinguish between insurable and noninsurable punitive damage judgments assessed against corporations.

A special interest has been taken in California, where case law on the issue of insuring against punitive damages is sparse. It has been observed that the problems faced by other states on this matter are largely absent in California. Statutory law purports to limit punitive damages to cases involving intentional torts and generally forbids any insurance coverage at all for intentional torts. In the rare case in which the issue of insurability of punitive damages might arise in California, it has been argued that analogous authorities would lead the courts of this state to find that such insurance would violate public policy. For the courts of this or any other state to hold to the contrary would tend to eviscerate the punitive effect that the doctrine of punitive damages was designed to achieve.

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